AN OUTLINE OF BANKING SYSTEM IN INDIA

BY

M. V. SUBBA RAO, M.A.,
Professor of Economics,
R. A. PODAR COLLEGE OF COMMERCE AND ECONOMICS
BOMBAY.

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PREFACE

In these few pages I have attempted to present to the general reader a brief account of the various institutions which constitute what is known as the Indian Banking System The division of India into two dominions necessitates dealing with banking problems pertaining in the main to the dominion to which we belong But the book was written when partition was still in process and hence the treament has been as if India was undivided Moreover partition has not brought about any basic and fundamental change in regard to these institutions, though their sphere of action has become restricted In any case it is too early to assess the repurcussions of the division of the country on the Banking system

I have endeavoured to use all available material on the subject and have taken every possible care Still it is possible that mistakes may be there and I should be grateful to the readers to point out these mistakes, if any, which I shall be glad to bear in mind

I owe a debt of gratitude to many in connection with the preparation of this book Of them, I feel I must express my sincere thanks to Mr R V Murthy, M A, Editor, *Commerce*, Bombay, for helping me by going over the manuscripts and to Principal L. N Welingkar of the Podar College of Commerce, Bombay, who has given me every facility for pursuits of this kind which has been a source of considerable encouragement to me

Bombay,
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M V SUBBA RAO

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CHAPTER I

DEVELOPMENT OF BANKING IN INDIA

It is now an established fact that India possessed some system of indigenous banking from very early times, though it was not similar to Banking on modern lines Evidence is forthcoming to show that money-lending existed even during the vedic period. History records the fact that, during the fifth century or thereabouts, the people were accustomed to the use of credit instruments like **Hundis**, etc The Buddhist literature also throws a flood of light on the various commercial and banking activities of the period References are found in the early literature of the period to **sreshtis** or bankers who flourished in important towns like Champa, Rajagriha, Sravasti, Kausambi, and Avanti Their main function was to finance the traders for the ordinary purposes of their trades, the merchant adventurers who went out by sea to foreign countries or explorers who traversed forests in search of valuable materials, and Kings in times of war and other financial stress [1]

Writers on **Dharmasastras** and **Arthasastras** refer to rules regarding the rates of interest, though the former restricted the activities to a particular section of the Hindu community, viz **vaisyas** It was, indeed, to protect the borrowers that the law of **Damdupat** was recognised and enforced under Hindu jurisprudence

Muslim historians of the twelfth century also refer to "the existence of Multanis and Shroffs who not only financed internal trade and commerce but also acted as bankers of the ruling dynasties of the period" It is also believed that foreign trade was greatly financed by the indigenous bankers An even more important function that these bankers were performing, apart from lending money, was the business of money-changing, which was so necessary in those days when a large number of mints issued metallic currency of various denominations causing great embarrassment to the public They also acted as revenue collectors, bankers, and money-changers to Government. For their power and influence, the Jagat Seths or World Bankers of the seventeenth and eighteenth centuries are comparable with any private banking house in any other

(1) Report of the Central Banking Enquiry Committee (1931), Volume 1, page 12

country, and, indeed, they seem to have fulfilled many of the functions of a Central Bank—essentially a modern institution [1]

With the advent of the English traders in the seventeenth century and the establishment of trading centres by the East India Company, the indigenous bankers found their position precarious Being unable to use the indigenous bankers for their trading and banking purposes, the East India Company encouraged the establiment of what were known as the Agency Houses [*] The English Agency Houses, established in Bombay and Calcutta, took upon themselves the business of banking in addition to their commercial and trading activities The flourishing trade which the East India Company carried on with the help of those Agency Houses is probably one of the factors which induced that company to oppose the establishment of banking institutions in India by the European trading Houses in London trading with India and the East However, the activities of these Agency Houses were restricted to Port towns, and the indigenous bankers continued to have their trade in the interior parts of India The indigenous bankers, however, lost their most important business of moneychanging, when the Coinage Act was passed in 1835 abolishing the several coinage systems already existing and establishing a unified currency system

The founding of Agency Houses,[**] which were semi-banking institutions, has already been referred to In addition, the Presidency Banks and a number of Joint-Stock Banks[***] were established at the same time It is a matter of controversy whether the first Bank was founded in Madras[2] or at Calcutta [3] Of the Banks established during this period the Presidency Banks are conspicuous The earliest to be established was the Bank of Bengal which received its charter in 1809 The Bank was established to enable the Presidency Government to facilitate its bor-

(1) Report of the Central Banking Enquiry Committee (1931), Volume 1, page 13

* The Agency Houses of Messrs, Alexander & Co , founded the Bank of Hindustan in 1770 Messrs Palmer & Co , founded the General Bank of India in 1806

** The Agency Houses of Alexander & Co , Colin & Co , Maintosh & Co , Collendon & Co , Palmer & Co , perished in 1829-30.

*** The Banks established at this time are the General Bank of India, and the Bank of Hindustan The former perished in 1829

(2) Dr M S Natarajan, *A Study of the Capital Market of Madras Presidency*, page 4

(3) C N Cooke, quoted by the Central Banking Enquiry Committee, Report (1931) Vol 1, page 16

rowing and other Government business Later on, the Banks of Bombay and Madras were established in 1840 and 1843, respectively The Bank of Bengal had a capital of Rs One crore, of which the Presidency Government contributed one-fifth while the Banks of Bombay and Madras had capitals of Rs 50 and Rs. 30 lakhs, respectively, of which the Governments of Bombay and Madras subscribed Rupees three lakhs in each case All the Presidency Banks had the right of note issue, transacted business of their respective Governments, and particularly helped them in their borrowing activities and generally acted as Bankers to the Governments of the Presidencies The Banks were, however, not allowed to deal in foreign exchange When the Bank of Bombay involved itself in the cotton crisis of 1862, resulting eventually in its liquidation, the need for controlling these banks was felt

A new Bank of Bombay was established with a capital of Rs One crore and, at the same time, restrictions were imposed on the Presidency Banks They were particularly deprived of the right of note issue in 1862 In order to compensate these banks for the loss caused to them by the loss of the right of note issue, they were given the free use of Government balances and were appointed as agents to the new issue of notes by the Government By the Presidency Banks Act of 1876, the activities of these banks were regulated and their business restricted At the same time, the Presidency Governments divested themselves of the interest they had in these banks by disposing of the shares held by them and discontinuing to appoint their nominees on the Directorate of the banks The Presidency Banks continued as independent entities with the patronage of the respective Presidency Governments till 1920 when they were amalgamated into the present Imperial Bank of India

The following figures indicate the progress of the three Presidency Banks from 1870 to 1920 —

(figures in Crores of Rupees)

Year	Paid up capital Rs	Reserves Rs	Govt, or Public Deposits Rs	Private Deposits Rs	Cash Balances Rs	Investments	Loans Advances.
1870	3 36	25	5 43	6 40	9 97		
1880	3 50	55	2 91	8 49	7 41		
1890	3 50	97	3 59	14 76	12 97		
1900	3 60	2 00	2 80	12 88	5 04		
1910	3 60	3 31	4 24	32 34	11 35		
1920	3 75	3 78	9 03	78 02	26 03		

By the year 1860, a large number of joint-stock banks had been established. These banks, which worked on the principle of unlimited liability, issued notes and also transacted foreign exchange business Since many out of these banks failed, putting a large number of note-holders, depositors, and share-holders into loss, the Act of 1860 was passed to regulate banking by recognising the principle of liability, for the first time. The growth of banking was very slow, even after 1860,* and, at the end of the last century, there were only nine banks with a paid-up capital and reserves of Rs 5 lakhs and over Their aggregate paid-up capital and reserves was Rs 1¼ crores, while their total deposits amounted to Rs 9 crores. At the same time, the deposits of the Presidency Banks and Exchange Banks amounted to Rs 12 crores and Rs 10 crores, respectively

During the early years of the present century, mostly due to the "**Swadeshi Movement**," there was a considerable activity in banking activities as was the case in other spheres of economic life. By the year 1913, the number of banks with a paid-up capital and reserves of Rs 5 lakhs and over was 18, with a total paid-up capital and reserves amounting to Rs 4 crores and total deposits of Rs. 27 crores, respectively In the year 1925, there were 28 banks of this category, their paid-up capital and reserves amounting to Rs 10 60 crores and deposits amounting to 54 49 crores At the same time, there were as many as 46 "B" class banks with capital and reserves of Rs 1 18 crores and deposits amounting to Rs 3 41 crores, respectively Still the joint-stock banks did not compare favourably with either the Presidency Banks or the Exchange Banks, as the total deposits of the joint-stock banks was only Rs 58 crores, while the private deposits of the Presidency Banks alone was Rs 77 83 crores, and the deposits in India of the Exchange Banks was Rs 70 54 crores Even five years later, the joint-stock banks having a number of 31 of "A" class banks and 54 "B" class banks did not compare favourably either with the Presidency Banks or the Exchange Banks In that year (1930), the joint-stock banks of both "A" and

* The following were some of the important Banks —

The Allahabad Bank of India	(1865)
The Alliance Bank of Simla	(1874)
The Oudh Commercial Bank	(1881)
The Punjab National Bank	(1894)

"B" classes had total deposits of only Rs 67 56 crores as compared with the Presidency Banks (Imperial Bank of India) and the Exchange Banks which had Rs 76 60 and Rs 68 11 crores, respectively

By the year 1935, the joint-stock banks were able to gather strength and their total deposits amounted to Rs 89 43 crores as compared with the Imperial Bank of India and the Exchange Banks which had Rs 79 10 crores and Rs 76 17 crores, respectively The number of banks of "A" and "B" classes was 100 Their number increased to 180 (A and B class banks) in 1940, and in 1943, their number was 244 The deposits also increased from Rs 125 crores in 1940 to Rs 359 88 crores in 1943. The following Table shows the growth of joint-stock banks from 1870 to 1943

(figures in Crores of Rupees)

Year	"A" Class Banks: No of Banks	"A" Class Banks: Capital and Reserves Rs	"A" Class Banks: Deposits Rs.	"A" Class Banks: Cash balances Rs	"B" Class Banks: No of Banks	"B" Class Banks: Capital and Reserves Rs	"B" Class Banks: Deposits Rs	"B" Class Banks: Cash Balance Rs
1870	2	12	14	50				
1880	3	21	68	17				
1890	5	51	2 71	56				
1900	9	1 28	8 07	1 19				
1910	16	3 76	25 66	2 80				
1920	25	10 92	71 15	16 31	33	81	2 33	·41
1925	28	10 60	54 40	10 10	46	1 18	3 41	67
1926	28	10 84	59 63	9 12	47	1 26	3 47	82
1927	29	11 08	60 84	7 10	48	1 22	3 46	52
1928	28	11 10	62 85	8 19	46	1 20	3 50	52
1929	33	11 54	62 72	9 05	45	1 15	3 58	45
1930	31	11 90	63 25	7 68	54	1 37	4 31	52
1931	34	12 08	62 26	7 71	51	1 24	3 84	47
1932	34	12 21	72 34	9 76	52	1 29	3 93	68
1933	34	12 34	71 68	10 92	55	1 31	4 75	82
1934	36	12 67	76 77	11 14	69	1 49	5 11	72
1935	38	13 20	84 15	19 12	62	1 39	5 28	82
1936	42	13 95	98 14	15 28	71	1 47	5 46	1 00
1937	39	12 78	100 26	16 82	108	2 17	8 29	1 33
1938	43	13 14	98 02	14 20	120	2 41	8,72	1 29
1939	51	13 56	100 73	16 72	119	2 32	9.27	1 37
1940	58	14 65	113 98	26 26	122	2 43	11 04	2 24
1941	63	16 19	137 64	25 69	125	2 56	11 45	2 67
1942	69	19 01	202 74	47 29	136	2 71	15 60	4 59
1943	92	26 47	338 99	82 92	152	3 16	20 89	6 69

Progress of Banks having Capital and Reserves between Rs 1,00,000 and Rs 50,000

Year	Number of Banks	Capital and Reserves Rs.	Deposits Rs	Cash Balances. Rs
1939	112	77	2 98	52
1940	121	84	2 86	59
1941	124	90	3 93	98
1942	137	97	4 95	1 56
1943	141	98	6 26	1 97

Progress of Banks with Capital and Reserves of less than Rs 50,000

Year	Number of Banks	Capital and Reserves Rs	Deposits Rs	Cash Balances Rs
1939	400	76	2 63	38
1940	382	60	2 71	47
1941	147	26	84	13
1942	133	23	75	13

In addition to Indian joint-stock banks a large number of Banks, mostly of foreign origin, interested in the financing of the foreign trade of India were established in this country during the last century The East India Company and the Agency Houses for some time succeeded in preventing the establishment of such banks fearing competition from them However in 1862 the Oriental Trading Corporation was established and it obtained its charter to trade in India from the authorities in England without reference to the East India Company in India Thereafter one after another large number of Banks established in European and Asiatic countries opened their Offices in India The Table on page 11 shows the growth of Exchange Banks operating in India

Present position of Banking:

At the end of 1945, there were 75 scheduled banks operating in British India, there were 68 non-scheduled banks with capital and reserves of more than Rs 5 lakhs operating in British India and the more important states, 174 non-scheduled banks with capital and reserves between Rs 1 lakh and Rs 5 lakhs, 114 non-scheduled banks with capital and reserves between Rs 1 lakh and Rs. 50,000, and about 244 non-scheduled banks with capital and

(Figures in crores of rupees)

Year	Number of Banks	Capital and Reserves in Pounds (000,000) Rs	Deposits in India Rs.	Cash Balance in India Rs
1870	3	2 18	52	61
1880	4	3 07	3 40	1 80
1890	5	8 08	7 54	3 50
1900	8	15 77	10 50	2 39
1910	11	34 31	24 70	4 38
1920	15	90 22	74 81	25 17
1925	18	138 29	70 54	9 41
1926	18	148 00	71 54	10 72
1927	18	180 92	68 86	7 13
1928	18	187 92	71 83	8 05
1929	18	227 99	66 66	9 05
1930	18	193 62	68 11	7 71
1931	17	185 96	67 17	8 81
1932	18	173 85	73 06	9 60
1933	18	113 08	70 78	6,71
1934	17	141 62	71 40	7 67
1935	17	137 03	76 17	12 55
1936	18	127 90	75 03	10 27
1937	18	128 30	73 20	10 58
1938	18	131 51	67 20	6 44
1939	19	125 95	74 17	6 88
1940	20	128 24	85 32	17 19
1941	17	105 95	106 73	13 39
1942	16	106 69	116 85	12 20
1943	16	106 80	140 19	17 24

reserves of less than Rs 50,000 The total number of branch offices of the Scheduled Banks, including the Imperial Bank of India and the Exchange Banks was 2,933 The branch offices of the non-scheduled banks with capital and reserves of Rs 1 lakh and over numbered 1,934 during the same period The branch offices of banks with capital and reserves between Rs 50,000 and Rs 1 lakh numbered 448 The total number of banking offices of the Joint-stock category numbered 691 and their branches numbered 5,315 In addition there were as many as 50 co-operative banks with capital and reserves of Rs 5 lakhs and over and as many as 313 banks with capital and reserves between Rs 1 lakh and Rs 5 lakhs

Regional Distribution

At the end of 1945 there were in India as many as 1,250 places in British Indian provinces and 401 places in Indian States where there was either a joint-stock bank or a branch office of a joint-stock bank, or a co-operative bank or a

branch of a co-operative bank The largest number of places or towns having banking offices was located in the Madras Presidency and there were the least number of towns with banking offices in Sind Province Of these in about 125 places, of which the largest number of towns were located in Bombay Province, there was only a co-operative Bank The following table* is illustrative

Provinces	Number of towns	States	Number of towns
Madras	254	Travancore	65
Bengal	248	Mysore	32
The Punjab	184	Hyderabad	27
Bombay	172	Cochin	26
United Provinces	149	Patiala	24
Assam	48	Gwalior	22
Bihar	85	Baroda	21
Central Provinces and	64	Bikaner	18
Berar	19	Rewa	18
Orissa	14	Rajaputana States	17
N W F Province	13	Kathiawar States	11
Sind			

Even smaller states like Sangli, Kolhapur, Jind, Kapurthala, Tripura, Indore, Jaipur, Idar, Cutch, Bhavnagar, and Central-Indian states had organised Banks in their own territories The number of banks have increased particularly between 1939 and 1946, and the established Banking companies have also increased the number of their branch offices

* Compiled from the Statistical Tables relating to Banks in India, 1944-45.

CHAPTER II

PROBLEM OF RURAL CREDIT

The importance of agriculture as an occupation of nearly 70 per cent of the population hardly needs emphasis The problem of financial needs of such a large number of people must receive greater attention than what is being bestowed at present What place agriculture occupies in the national economy will be clear from the following statement "Agriculture is not merely a way of making money by raising crops, it is not merely an industry or a business, it is essentially a public function or service performed by private individuals for the care and use of the land in the national interest, farmers, in the course of their pursuit for living and private profit, are the custodians of the basis of the national life."[1]

In India, agriculturists are confronted with this problem acutely in spite of the country being vastly agricultural A brief resume of the problems which the agriculturists have to face in India will not be out of place in this context

First, there is the poverty of the masses which is beyond descripion "The depth of poverty, the pervading presence of which cannot escape notice," wrote the Simon Commissioners, "is not so easily realised"[2] The poverty is mainly the result of low income and heavy expenditure of which the land revenue imposes a crushing burden Various estimates have been made regarding the per capita income of the peasant These esimates rarely, if at all, give a correct picture However, it can be safely assumed that the income of an agriculturist is not higher than that of an industrial labourer

Secondly, there is the pressure of population on agriculture A very large number of people depend on agriculture and they have no subsidiary occupation to engage themselves in during the off-season The population depending on agriculture increased from 61 per cent in 1891 to 71 per cent in 1919 and to 73 per cent in 1931[3] The

(1) Report of the Businessmen's Commission on agriculture quoted by the Central Banking Enquiry Committee Report (1931), Vol 1, page 48

(2) Simon Commission Report, Volume 1, page 334

(3) Sir M B Nanavati and J J Anjaria, *Indian Rural Problem*, page 24

result is obvious "The great mass of population directly depends on agriculture and there is no other industry from which any considerable part of the community derives its support"[1]

The character of agriculture in India is such that it leaves no surplus or net return to the producer To a large majority of the people it is a mode of living rather than business, an economic proposition "To a great extent," wrote the Royal Commissioners, "the cultivator in India labours not for profit, nor for a net return, but for subsistence"[2] The average size of a cultivator's holding in India is very small[3] This has been the result of age-long sub-division and fragmentation of land, thanks to our law of heridity or succession Due to the small size of the holdings and their scattered character, no large-scale improvement has been possible But the factor that has prevented the cultivator from making improvements is not so much the small holding as the economic weakness and the low income of the peasant himself

Fourthly, the crops produced do not yield the farmer an adequate price Not that his produce has no demand But the inadequate price he receives is mainly due to the unorganised marketing conditions The cultivation of improved variety of seeds does not confer sufficient advantage

(1) Indian Famine Commission Report, quoted by the Central Banking Enquiry Committee Report (1931), Vol 1, page 41

(2) Report of the Royal Commission on Agriculture, quoted by the Central Banking Enquiry Committee Report (1931), Vol 1, page 53

(*) Size of holding	Percentage of owner's holdings to total holdings	Size of holding	Percentage of holdings to total holdings
Below 1 acre	17 9	Between 5 and 10	18 0
Between 1 and 3 acres	25 5	Over 10 acres	23 7
Between 3 and 5 acres	14 9		

Size of holding	Percentage of Cultivators to total cultivation
1 acre or less	22 5
Between 1 and 2 acres	15 4
Between 2 and 5 acres	17 9
Between 5 and 10 acres	20 5
Over 10 acres	23 7

(3) Royal Commission on Agriculture, pp 132-3

U S A	145 acres	Germany	21 5 acres
Denmark	40 acres	England	20 0 acres
Sweden	25 acres	India	5 0 acres

(B P Jain, *Agricultural holdings in the U P*, pp 26-27)

on the agriculturists, unless arrangements are made to procure an adequate price in the market, for "the disorganised condition of the cultivators, which, in certain cases, is accentuated by the existence of the powerful organisations of the buyers and the lack of credit facilities enabling them to hold on to their crops in times of plenty, often prevents them to have a fair share for their produce"[1]

Added to these is the ancestral debt The statement that the "peasant is born in debt, lives in debt, and dies in debt" cannot be considered an exaggeration The latest estimate made on the extent of rural indebtedness places the amount at Rs 1,200 crores[2] The following figures, however, were quoted by the Central Banking Enquiry Committee regarding the indebtedness in Provinces

	Rs		Rs
Assam	22 Crores	Bengal	100 Crores
Bombay	81 ,,	Burma	50 to 60 crores
Central Province	36 ,,	Coorg	35 to 55 crores
Punjab	135 ,,	United Province	124 crores
Bihar and Orissa	155 ,,	Central Areas	18 crores
Madras	150 ,,		

The important question, therefore, is to provide credit facilities to the agriculturist either to enable him to wait for sometime in selling his crops or to enable him to pay off his ancestral debts or to enable him to make permanent improvement in land But here, again, he has neither organization nor credit facilities to help him as in countries like the United States of America, Canada, Denmark, Germany, and other European countries Nor are the savings of the community accessible to him as they are to the industrialist and business man While the manufacturer raises his capital by subscription, the farmer must raise much of his capital by personal credit

Credit needs of Agriculturists:

Agriculturists require two kinds of credit depending on the duration and the purpose for which the credit will be utilised They are the short-term and the long-term credits, generally speaking, though, sometimes, their credit needs are classified into short-term, medium-term and long-term credits

(1) Report of the Royal Commission on Agriculture quoted by the Central Banking Enquiry Committee Report (1931), Vol 1, page 44
(2) The Bombay Plan, page 31

The short-term credit is required to meet the current outgoings and to facilitate production. The current outgoings and expenses of production include the buying of cattle, agricultural improvements, purchase of manure and seeds, expenses of transplantation, in the case of wet cultivation, weeding, and hoeing of dry crops, and of reaping, gathering and threshing, maintenance of the farmer and his family and livestock, payment of revenue and rent, the outlay on the various items of improvements effected in the ordinary course of husbandry, such as levelling, deep ploughing, irrigation, clearance, draining, and fencing, etc

The short-term credit is also required at the time of the harvest so as to enable him to meet his current expenditure, particularly the payment of land-revenue, so that he may not be under pressure to sell his crops immediately being in need of money. Any short-term credit must be capable of being repaid or liquidated as soon as the crops are sold The importance of credit for this purpose can hardly be exaggerated, "as their poverty, ignorance, and debt obligations compel them to sell their crops at whatever price these may fetch immediately the harvesting is over" and "as it is necessary to create credit facilities enabling them to withhold from the market a portion of their supply and exercise a certain degree of control over the price [1]

The long-term credit is required for obtaining fixed capital to be invested permanently for long periods It may be for the purchase of land or for acquisition of costly equipment, consolidation and improvement of holdings, or for the repayment of a past debt

While the security that the agriculturist is able to offer for short-term credit is his personal security and the security of his crops, that for long-term credit is his lands and other immoveable property

The various credit agencies engaged in rural finance directly or indirectly are the indigenous money-lenders and bankers, the co-operative movement, land mortgage banks, commercial banks, the Government and the Reserve Bank, which we shall discuss in later chapters

(1) Report of the Central Banking Enquiry Committee (1931), Vol. I page 46

CHAPTER III

RURAL CREDIT AGENCIES

INDIGENOUS MONEYLENDERS AND BANKERS

Of all the private agencies, the individual moneylender* is by far the most important both from the point of view of numbers** and from that of volume of business The Central Banking Enquiry Committee Report has classified moneylenders into professional and non-professional, and these again into rural and urban, internant*** and others. Of these, the most conspicuous is the rural moneylender, whether he is professional or non-professional, or an agricultural moneylender A moneylender may be defined as a person who lends money with or without security in the course of his business

Moneylender's resources:

A moneylender generally works with his own capital or by borrowing from urban moneylenders The urban moneylenders, in turn, borrow from the indigenous bankers, merchants and traders having dealings with joint-stock banks, Co-operative banks and societies

System and methods of business:

The methods of business and the system of accounts of a rural moneylender are simple, though such may differ from Province to Province In the same Province, too, each moneylender may have his own methods of business for each transaction, mostly depending upon the circumstances of the debtor, the nature of the security, and the locality and the resources of the moneylender himself Loans are often made on mutual trust, sometimes, even without a witness, and, sometimes, on the security of immoveable property Loans are made on simple, usufructuary mortgages and, sometimes, on mortgages with a condition of sale attached to it When it is a short-term loan, the moneylender accepts personal security, or he advances on the security of crops Where it is a substantial sum and

* A moneylender is known under different names in different Provinces He is known as the *bania, mahajan, sahukar, aurora, nanavati*, and *chetty*

** The number of moneylenders and bankers increased from 52,263 in 1868 to 1,93,890 in 1911 (Thomson & Garret, *Rise and Fulfilment of British Rule in India*—pages 487-88)

*** The internant moneylenders are the *Pathans, Kabulis* and *Quistwalas*.

a long-term loan, he demands adequate security. He has neither account books nor any establishment like his city-counterpart (City Banker) In certain cases, the moneylender also combines the business of a trader In ancient India, the moneylender did a useful service and with the cohesion of the village community and the local panchayat and with the honesty of the debtor, he was indeed a friend to the people His (later day) practices are not commended by any of the banking committee reports. His aim, and sometimes the sole object, is to get possession of the lands of his debtors [1] Landlords are dangerous Creditors as they acquire a double hold on the tenant-borrows [2] In short, the practices of the moneylender have been summarised as follows "He is certainly no philanthropist, his object is to make money, and he is not always particular regarding the means by which he does it He will deduct the future interest from the principal before he pays it He will cause an illiterate borrower to put his thumb impression on a blank form and subsequently fill it with a sum in excess of the amount actually lent It is to him that the needy peasant turns for help in every trouble It is he who finances the marriage ceremony and law-suits, the one as inevitable as the other"

The rates of interest charged by the moneylenders vary from Province to Province and, in the same Province, from individual to individual in each case, depending upon the circumstances of the debtor, the need for a debt, and the security that the debtor is able to offer, and the resources of the moneylender himself, as already stated *

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 76 (quoting the Punjab Committee Report)

(2) United Provinces Committee Report, quoted by the Central Banking Enquiry Committee Report (1931), Vol 1, page 76

*Bombay	12 to 25% rising upto 50% in Sind
Madras	12 to 24% rising to 36 to 48%
U P	7 to 12%, 18 to 37½% village Sowcar, 25 to 30% Grain loans
Bihar and Orissa	18 % to 37½% for cash loans, 25 to 50% for Grain loans
Assam	12 to 75%
The Punjab	6 to 12% for secured loans Loans secured no limit
N W F	5 to 18% secured, other cases 13 to 36 %
Ajmer and Merwar	6 to 13½% for secured loans, 12 to 18% unsecured, Delhi secured 12 to 24%
Bengal	10 to 37% and 47 to 30%
Burma	18 to 24½% or 37 % for Cash loans, 48 to 60%

(The above figures are quoted by the Central Banking Enquiry Committee)

Legislative Measures to Control Moneylenders' Activities:

While it is true that the moneylender is the most important constituent of the agricultural credit machinery, it is not possible to justify many of his practices and the charges he makes for his services The charges he makes are very often out of proportion to the risk involved in the business and constitute an exploitation of the helplessness, ignorance, and necessity of the borrower Nor is the agricultural economy able to bear the strain of his extortion The credit dispensed by him, instead of contributing to the agricultural prosperity of the country, serves as a serious drag on it [1] It is therefore, necessary to regulate his activities, particularly so the exorbitant rates of interest, and these unconcionable rates of interests have been, to some extent, reduced by the intervention of courts in individual cases where the intervention of courts is sought by the borrower under the earliest legislative measures adopted by various Provincial Governments

The first enactment was the Usurious Loans Act passed in 1918, which empowered the courts of Law to reopen and question all unjust and unfair transactions This had proved a dead letter Even the Royal Commission on Agriculture said it was so The main defect of the Usurious Loans Act was "that the entire machinery of providing relief to the agriculturist-debtor in respect of his interest payments was left to the initiative and discretion of the courts of law", but the courts, in trying the cases, had to be guided only by legal issues and, in many cases, what was a just rate of interest would be impossible of decision, for that would be a question of fact and not a question of law Even when courts awarded just rates of interest taking into consideration the circumstances of the transaction etc, therefore, the rates worked hard on the agriculturist-borrower As the need for making suitable amendments to earlier legislative measures, and even enacting fresh legislative measures was felt, the various Provincial Governments enacted the necessary legislation The main features of the Provincial legislation are three-fold and pertain to (1) to registration and licensing of moneylenders, (2) regulation of accounts, and (3) the regulation of interest

The moneylenders' Acts of most of the Provinces provide for compulsory registration and licensing In certain Provinces like the C P, failure to obtain a registration cer-

(1) Report of the Agricultural Finance Sub-committee (1914), page 50

tificate is punishable by a fine, and in the U P. it is punishable with fine in addition to other penalties. In some Provinces like the Punjab, failure to register will deprive the moneylenders of the right to seek the aid of Courts of Law to enforce their claims, but, in certain cases, they can enforce their claims only on payment of a fine

The second feature of these legislative measures is that they refer to regulation of accounts The Acts provide for the maintenance of accounts of each debtor separately in a prescribed form showing the particulars of the debt, interest amount etc, and also for the grant of receipts for payments received. In some Provinces, it is to be furnished annually and, in others, only when demanded These Acts also provide that, when the moneylender-creditor has failed to maintain accounts, interest and costs may not be allowed In some Provinces like Orissa, failure to maintain proper accounts is an offence punishable with fine, while, in Bihar, it is punishable with imprisonment or fine, or both In most of the Provinces, failure to maintain proper accounts make the moneylender liable to the cancellation of his registration and licence.

The third feature of the legislative measures to control moneylending relates to regulation of interest payments The Usurious Loans Act was amended for that purpose The Act as amended defines what rates should be deemed usurious Further, in most Provinces, entry in the document of an amount higher than the principal actually advanced is made punishable

In Assam, any advertisement of moneylending business is an offence punishable with fine or imprisonment or both

Working of the Moneylenders' Acts:

In most Provinces, the provisions of the Moneylenders' Act are disregarded No data are available about the number of moneylenders in each Province, or the number of those who have got themselves registered and licensed under the Act In the Punjab, while the number of moneylenders was estimated by the Provincial Banking Enquiry Committee at 55,000, only 17,438 moneylenders had registered themselves upto 1940 In the Central Provinces, upto 31st March, 1939, 37,796 moneylenders were registered out of a total of 39,068[1] It is reported that many small moneylenders have wound up their business because of

(1) Report of the Agricultural Finance Sub-Committee (1944), page 61.

the provision relating to the keeping of accounts On the whole, legislation to control moneylenders has so far proved ineffective

While the moneylending legislation has resulted in the shrinkage of credit to the agriculturist, the question as to whether moneylender should continue as an agency financing rural needs require to be answered The Central Banking Enquiry Committee held the view that the proposal to introduce a system of licensing moneylenders, either compulsorily or voluntarily was not necessary and, therefore, they were not in favour of it, for they believed that the moneylender had a useful role to play. They suggested that moneylenders may be induced to join co-operative societies under certain conditions, viz, that they ceased lending privately to members of such societies, that in course of time, joint-stock banks may entrust registered moneylenders, as they grow in strength and inspire more confidence, with such agency functions as accepting deposits, making remittances and payments

It is true that the moneylender played a beneficent role in ancient India In pre-British days there were two factors which prevented the moneylender from making unconscionable and unjust bargains First, the village was a cohesive and co-operative unit where public opinion was strong and the moneylender was bound to bow down to the public opinion Secondly, the State was indifferent in the matter of recovery of loans, interest etc, as this function was performed by the village **Panchayat** and questions of dispute were settled "equitably, promptly, and summarily" Under British rule, these checks have been largely removed The disintegration of the village community weakened the position of the cultivator and the moneylenders and landgrabbers fully utilised their opportunity, their superior shrewdness and resources to exploit the cultivator [1] Under the new economic set up the moneylender is an anachronism and, as legislation has failed, institutional credit and co-operative finance should take the place of individual credit

II

Indigenous Bankers

Lending money is not the only business of an indigenous banker In fact, his most important business is banking, such as the discounting of **hundis** and making remit-

(1) G B Jathar and S G Beri, *Indian Economics*, Vol 1, page 256

tances, etc An indigenous banker finances industry and trade rather than consumption, but the moneylender finances consumption. Both the banker and the moneylender advance partly with, and partly without, security the banker more often with than without, and the moneylender probably more often without than with Even so, the distinction between a moneylender and a banker lies in the amount of capital owned and is often a question of degree

Although exact figures are not available, there are large number of indigenous bankers ' Indigenous banking is mainly restricted to certain castes and communities.**

The indigenous bankers carry on their business from their own resources and from deposits received from the public These deposits may be in the form of current or fixed deposits The **Marwari** bankers rarely depend on deposits, much less do they borrow from banks They mostly rely on the funds of their community at Rajaputana which are available to them at the rate of 4 to 7 per cent **Multani** bankers also depend on their own resources, and they too borrow at comparatively low rates of interests of 4 to 6 per cent from their community at Shikarpur Occasionally, they also borrow from Banks

No reliable estimates of the capital employed are available for all the Provinces, but it is recognised that, amongst the agencies financing agriculture, internal trade, and small industries, the indigenous bankers occupy a prominent position. **The Natukottai Chettiar** capital employed in Burma was estimated at Rs 75 crores, of which a sum of Rs 53 crores was supplied by proprietors of the firms, about Rs. 10 crores were borrowed from non-**chettiar** resources, and Rs $2\frac{1}{2}$ crores obtained by deposits

Province.	*Number*
Madras	No figure
Bombay ..	20,000 (including moneylenders).
Bengal .	No figure (Number declining)
United Provinces	250 (number of firms 7)
The Punjab	66
Burma	The Chettiar Offices numbered 1,650
Bihar and Orissa	1,00,000 doing moneylending part of banking business, 700 shroffs paying Income-tax
Central Provinces	1 firm
Assam	No information
Central Provinces	29 in Ajmer-Merwara, 43 in Delhi 23 Hindu bankers in N W F in addition to large number of Muslims

** The following castes and communities are engaged in indigenous Banking business —

Multanis, Marwaris, Natukottai Chetties, and *Kalladkurchi* Brahmins.

The indigenous bankers accept deposits As in the case of joint-stock banks, the rates of interest offered by them for current deposit differ from those paid on fixed deposits, and these further vary according to Provinces *

The rates charged by them also vary from Province to Province, the status of the borrower, and the condition of the money market **

Their methods of business are simple, their accounts are kept in a simple and economical way, but they are accurate and efficient They usually carry on the business of discounting **hundis**, financing agriculture through money-lenders, and financing small-scale industries and trading activities

The indigenous bankers draw and discount internal bills of exchange or hundis A hundi is **darshani** when

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* The Central Banking Enquiry Committee Report (1931) quotes the following figures relating to rates of interest paid by indigenous bankers when it conducted the enquiry

	Current	Fixed
Assam	4 to 9½%	6 to 7½%
Bombay	4 to 4½% (busy season)	3 to 4½% (slack season)
Bengal	3 to 9%	6 to 12%
Bihar and Orissa	to 6% (1st class Shroff)	6 to 9% (2nd class Shroff)
Central Provinces	5 to 6% (on deposits for 12 months	
Delhi	3 to 5% (and 6 to 7% for 6 months)	
N W F	3 to 8%	
Madras	The rate varies	
The Punjab	upto 6%	
United Provinces	4 to 9% They borrow from each other	

** The Central Banking Enquiry Committee Report (1931) quotes the following rates of interests charged by the indigenous bankers

"In Assam the rate varied from 9 to 12% to village moneylender to 18% to others In Bengal interest varied from 7½% to 15 to secured loans, from 18 to 37½% to unsecured loans On Khalpeta it was from 6 to 9% and on promissory notes it was from 2 to 9%, Muddati from 4 to 12% and to non-traders from 12 to 18% In Bombay for internal and other purposes 6 to 12% In Central Areas (Ajmer-Merwara) the rate varied from 6 to 7½% on ornaments, 7% on produce and railway receipts, 9% on landed property, and 6 to 9% on personal security In Delhi it varied from 9 to 12% on mortgaged property, 9 to 10% on ornaments, 6% for loans for 8 or 10 days on verbal security, 7½% on loans to *arhatiyas* and cloth merchants, 9 to 12% on loans to grain dealers and vegetable merchants In the North Western Province the rate varied from 9% on pronotes of 60 days and to 4 to 8½% Muddati pendries In Central Province the rate varied from 7 to 9½% on loans on gold and silver, to 7 and 7½% to loans on grains and other produce in godowns In Madras the *Chettiar's* rate varied from 7 to 18% on mortgages in towns and 9 to 15% on mortgages in villages, on clean loans the rates were 9 to 12% in towns and 9 to 18% in villages *Multani's* rate varied from 9 to 13% for small loans to 18 to 24% on weak security. *Marwari's* rate varied from 9 to 12% on mortgages to 12 to 15% on produce and 12 to 18% on pro-notes The *Kallada Kurchi* the brahmins' rate varied from 9 to 12% on *hundis* upto 15% for others In the Punjab the rate varied from 8 to 9% for all kinds of loans and in the United Provinces it was from 7 to 12% for all loans (Central Banking Enquiry Committee Report (1931), Vol 1, pp 100-101

it is payable on demand and **Muddati** when it is payable after a specified period of time A **Darshani hundi** may be **dhanijog, shahjog, firmanjog** or **Dekhandar,** all depending on the mode of payment If the bill is **dhanijog,** it is payable to the payee only If it is **shahjog,** then it is payable to any respectable merchant or Shah A **firmanjog** hundi is payable to any person or order A **Dekhandar** hundi is payable to bearer

A **Muddati** hundi may also be drawn in different forms, depending on the person and the mode of payment The rates which the indigenous bankers charge for the discounting of **hundis** is called the **bazaar** rate of discount which varies from 4 per cent to 12 per cent all depending on the conditions in the money market and the resources of the indigenous bankers Even as between Bombay and Calcutta these rates differ

Secondly, indigenous bankers grant loans to money-lenders in rural areas who, in turn, lend to agriculturists, in addition to financing traders either on promissory notes, or on bonds or mortgages

The business of the indigenous bankers was clearly stated in a communication to the Reserve Bank of India by the President of the Bombay Shroffs' Association, detailing their activities as follows

"Buying and selling bills of Exchange, **hundis** and drafts, the negotiation of loans and advances, the collecting and transmitting of money, acting as agents for any person or persons, carrying on agency business of any description, financing or assisting in financing any business, acquiring, by purchase or otherwise, any property immoveable or moveable, acquiring any rights or privileges which they may think necessary or convenient to acquire or the acquisition of which is likely to facilitate the realisation of any securities held, or to prevent or diminish any apprehended loss or liability, managing, selling, and realising all property moveable and immoveable which may come into the possession of   in satisfaction or part satisfaction of any of   's claims, acquiring or holding and generally dealing with any property any right title or interest in any property moveable or immoveable which may form part of the security for any loans or advances, or which may be connected with any such security, doing all such things as are incidental or conducive to the promotion or advancement of the business "[1]

(1) Reserve Bank of India, *Statutory Report*, page 61

In recent years, the indigenous bankers have combined trading with banking As their banking business has considerably declined owing to the competition of joint-stock banks and co-operative banks, they have been tempted to make up their lost ground in banking by resorting to trading activities Even their business of financing internal trade is being gradually taken away from them owing to the establishment of branches of importing firms and exporting firms, with the consequence that they have taken to trading more and to banking less

The indigenous bankers maintain a close relationship with the money market Generally to those indigenous bankers whose names are on the approved list of joint-stock banks, the Imperial Bank grants discounts and advance facilities In the busy season, the Imperial Bank rediscounts **hundis** for them They are also given remittance facilities by the banks

After examining the position of indigenous bankers the Central Banking Enquiry Committee came to the conclusion that some action should be taken to improve the position of indigenous bankers to make them useful members of the Indian Banking system and that no compulsory measures should be taken to help or re-form indigenous bankers If they were compelled, the Committee opined, it would only accelerate the process of driving out these bankers from banking proper to other spheres of action. They, therefore, proposed that, as soon as the Reserve Bank was established, the indigenous bankers, along with joint-stock and co-operative banks should be brought into direct relations with that institution thereby providing them with rediscount facilities But the Committee also recognised that "the Reserve Bank could rediscount only eligible paper and that only those indigenous bankers as are engaged in banking proper or are prepared to shed their business other than banking, should be eligible to be placed on the approved list of the Reserve Bank in the same manner as the joint-stock banks"

The Reserve Bank and the Indigenous Bankers.

The Reserve Bank of India made attempts to link indigenous bankers with itself, but these attempts failed, as the indigenous bankers' associations were not agreeable to the terms of the Reserve Bank However, the Reserve Bank has maintained a list of indigenous bankers to whom it has been offering remittance facilities

CHAPTER IV

RURAL CREDIT AGENCIES

CO-OPERATIVE MOVEMENT

We have seen in the preceding chapter the various attempts made to control the activities of the moneylender and smoothen the terms on which the peasant can get credit from him, and we have also seen how legislation in that respect has not been quite effective We will now consider the part played by the Co-operative movement, as it is generally believed that a solution of the problem lies in the spread of the co-operative movement which not only supplies agricultural finance at reasonable terms but also ensures its proper use

The co-operative movement is only of recent growth. The first Co-operative Act was passed in 1904 for the organisation of credit societies The Act was again amended in 1912 to make it possible for the movement to organise non-credit agencies, as also to constitute central banks and provincial banks With the transfer of co-operative portfolio to Provincial Governments, the movement has made advance The Table below shows the growth of co-operative societies

STATEMENT SHOWING THE NUMBER, MEMBERSHIP, AND WORKING CAPITAL OF AGRICULTURAL SOCIETIES .

(Including cattle Insurance and Land Mortgage Banks) and Total Working Capital

Average for 5 years	Number of Societies		Membership		Working Capital (Rs 1000)
	Agricultural	Total	Agricultural	Total	
1906-07 to 1909-10	1,713	1,926	1,07,643	1,61,910	6,812
1910-11 to 1914-15	10,891	11,786	4,59,096	5,48,253	54,842
1915-16 to 1919-20	25,873	28,477	9,02,930	11,28,961	1,51,847
1920-21 to 1924-25	51,716	57,707	16,61,098	21,54,687	3,63,626
1925-26 to 1929-30	83,093	93,936	27,91,562	36,88,841	7,48,913
1930-31 to 1934-35	93,149	1,05,714	30,63,628	43,22,269	9,46,106
1940-41	1,23,976	1,42,510	44,46,452	64,00,787	10,93,229
1941-42	1,26,474	1,45,424	46,88,966	67,35,233	11,24,225
1942-43	1,26,305	1,46,160	46,13,261	69,12,094	12,11,432
1943-44	1,35,086	1,55,706	49,40,117	76,85,820	13,22,147
1944-45	1,36,647	1,59,633	51,52,070	83,55,189	14,66,338

At the bottom of the co-operative structure, there is the primary society, credit and non-credit, agricultural and non-agricultural. The agricultural societies are far greater in number than the non-agricultural societies Above the primary societies there are the central banks, and, finally, at the top, there are provincial banks.

Primary Society:

A primary society is an association of borrowers and non-borrowers consisting of residents of a particular locality It is usually based on the Raiffeissen societies of Germany and works on the principle of unlimited liability, unless otherwise provided A society may be a credit society or a non-credit society An agricultural credit society is of immense significance to the agriculturists in the matter of providing credit to them It has a limited area of operations, usually a village or a group of villages The management of the society generally vests in a committee of management consisting of five to ten members of whom the President and Secretary constitute important executives They are elected annually by the general body of members The President and the Secretary work honorarily

The Society gets funds for its working capital from entrance fees, share capital, deposits or loans from non-members, from central or provincial co-operative banks, from Government, the Reserve fund and other funds The share capital is not much, because agriculturists cannot invest much Deposits received by the society are of different kinds They may be fixed, savings, recurring. Deposits from members are not much for the members join the society only to satisfy their credit needs Even so, the deposits that a society is able to obtain invariably depend upon the rate of interest the society is able to pay and the confidence it is able to infuse among the public As the society is generally based on the unlimited liability basis, the well-to-do rarely join the society for fear of being involved in losses A further factor militating against the society depending on deposits for working capital is that, in the **mofussil**, "the needy form a distinct group from the well-to-do" and, unless there is security to the well-to-do for their money and "effective co-ordination and harmony between the two, the surplus of the latter will not flow to the former" The soundness of the society and co-operation among all classes of members are therefore factors, that determine the successful working of any society Like any

other financing institution, a co-operative society is a small bank or a credit institution for providing financial assistance to its members, but only on a co-operative basis

The society provides short-term credit to its members generally on personal security with sureties witnessing it and, sometimes, on mortgages Agricultural produce kept in godowns under lock and key of a society is becoming a common form of security in recent years [1] A society generally lays down the amount that can be borrowed by an individual member The object is, evidently, to discourage the members from borrowing for unproductive purposes At the end of 1944-45, there were, in all, 136,358 agricultural societies, of which 115,780 were credit societies The number of members of all agricultural societies were 50 lakhs and the aggregate amount of working capital was Rs 30 53 crores Of this, the share capital amounted to Rs 5 20 crores and reserve funds and other funds to Rs 7 99 and Rs 2 09 crores respectively The members' and the non-members' deposits amounted to Rs 2 39 and to Rs 1 82 crores respectively The Table on Page 26 shows the position of these societies at the end of 1944-45

Central Banks·

In the earlier stages, the credit societies were financed by urban banks, which, in course of time, assumed to themselves the position of central banks The number of such central banks and their importance increased after 1912, with the publication of the Maclegan Report

A central bank is a federation of primary societies in a specified area The term "Banking Union" is applied to such a federation when a central society admits as its members not only primary societies but also individuals When the membership is confined to societies only and individuals are excluded, the term "banking Union" is applied In practice, the differentiation is practically disappearing, and individuals are also members in most co-operative banks everywhere

A central bank derives funds for its working capital from (a) capital, (b) reserves, (c) deposits, and (d) loans Of these, capital and reserves are known as "owned capital," while deposits and loans are called "borrowed capital The deposits may be of various kinds, such as fixed, current, recurring, or prudent, or they may be provident and savings deposits Working capital by means of loans may

(1) W R S Satthianadhan & J C Ryan, *Co-operation*, page 8

consist of overdrafts and short-terms from the Imperial Bank of India or joint-stock banks or from Provincial or from other central banks or from Government Of these, the joint-stock banks seldom provide funds to central banks, but the Imperial Bank of India assists them considerably by means of cash credits[1] Another source of funds for these central banks is the deposits of surplus funds of the primary societies affiliated to them

These central banking organisations are generally located at the headquarters of, or other important towns in, the districts and have, on their Boards of Management, individuals of influence and business capacity in addition to representatives of primary societies

The business of these central banks consists in financing primary credit societies They also act as balancing centres to them Generally, they do not transact any commercial business However, central banks in Bombay and Madras do banking business, such as acceptance of deposits, collection of bills, cheques, **hundis**, keeping of valuables in safe custody, purchase and sale of securities, advancing, at times, loans to individuals against fixed deposits, Government paper, gold and silver and agricultural produce Central banks in Bombay have developed, to a large extent commercial business of advancing loans against agricultural produce and in order to facilitate this business, several of them have introduced the system of normal membership to their clients[2] At the end of 1944-45, there were in British India and Indian States, 602 central banks and banking unions with membership of 83,914 individuals and 116,411 societies Their share capital amounted to Rs 2 92 crores, reserve and other funds to Rs 2 47, and Rs 2 65 crores respectively, deposits from societies and individuals to Rs 27 81 crores, loans from Provincial Banks to Rs 3 31 crores and funds from Government to Rs 0 63 crores The net profits of these banks amounted to Rs 52 lakhs

Provincial Co-operative Bank

At the top of the co-operative movement, there is the Provincial Co-operative Bank The need for establishing such Provincial Co-operative Banks was emphasised by the Maclegan Committee, as it found, after investigation, that central banks found difficulty in securing funds locally The result was that they were found borrowing from each

(1) W R S Satthianadhan & J C Ryan, *Co-operation*, page 12
(2) Sir M B Nanavati and J J Anjaria, *Indian Rural Problem*, page 195

other In order to put an end to this unsatisfactory state of affairs, therefore, the Maclegan Committee recommended the creation of a Provincial Co-operative Bank which would be a bank "capable of attracting deposits from the richer urban classes and more suitably equipped to serve as a channel between the co-operative movement and the joint-stock banks Most Provinces in India have Provincial Co-operatives Orissa and N.W.F have no Provincial Co-operative Banks Some Indian States, such as Mysore and Hyderabad, have similar institutions and are known as Apex Banks The constitution of these banks is not the same in all Provinces, though the method of working is the same In a large majority of cases the constitution is a mixed one, in that, both in the general body and on the directorate, there are individual shareholders in addition to representatives of co-operative banks and central banks. There are no individual shareholders in the Punjab and Bengal Provincial Co-operative banks In the Provincial Banks of Bombay, the Central Provinces and Berar, and Assam, there are primany societies as well as central banks as members Only in Madras, central banks are members of the Provincial Banks to the exclusion of primary societies

The Provincial Co-operative Banks obtain funds for their working capital from deposits of affiliated societies or branches or from both as the case may be, as also from deposits by the public

The Provincial Co-operative Bank is usually managed by a Board of Management or Directors The composition of the Board is not the same in all the Provinces The Boards of Management of Provincial Banks of most of the Provinces consist of representatives of individuals and societies, except in the case of the Boards of Management of the Punjab and the Bengal Provincial Co-operative Banks which have representatives of shareholding societies only The Registrars of Co-operative Societies are **ex-officio** members of the Boards of Management of the Provincial Banks of the Punjab, the Central Provinces and Berar, Bihar and Sind In addition, the Punjab Provincial Co-operative Bank has on its Board the Financial Adviser of the Co-operative Department as a member. Similarly the Financial Adviser to the Bihar Government also is a member on the Board of Management of the Bihar Provincial Co-operative Bank On the Board of Management of the Central Provinces and Berar Co-operative Bank, it is the Financial Secretary who is a member

The functions of the Apex Banks or Provincial Co-operative Banks are to give financial accommodation to the Central Co-operative Banks and, through them, to the primary societies They also carry on ordinary banking business, such as "collecting hundis and dividends from companies and collecting the pay and pensions of the public servants" At the end of the year 1944-45, there were 9 Provincial Co-operative Banks in British India and 2 in the Indian States of Mysore and Hyderabad. Their membership consisted of 6,495 individuals and 19,519 societies The total working capital of the Provincial Co-operative Banks, including those in the Indian States, during the same period amounted to Rs 20 58 crores, of which the share capital amounted to Rs 0 96 crores, the reserve fund and other funds to Rs 0 62 crores and Rs 1 12 crores, respectively The deposits from individuals and other sources amounted to Rs 8 83 crores, and the loans from Government amount to Rs 0 30 crores

Except in Bombay and Sind the Provincial Banks do not advance loans directly to the primary societies The Bombay Provincial Co-operative Bank, however, acts as a financing agency for societies in nine districts through 31 branches Since 1934-36, the Sind Provincial Co-operative Bank has been advancing directly to the primary societies In Madras, the Reserve funds of the central banks are deposited with the Provincial Co-operative Bank [1]

Conclusion

The success or otherwise of the co-operative movement depends, first, upon the fact whether the institutions and the movement are financially sound, and, secondly, whether the Co-operative movement has fulfilled the objects for which it was established The real test of success of the co-operative movement lies in whether or not it has been able to provide adequate credit at cheap rates and on reasonable terms to the agriculturists, in other words, in whether it has been able to relpace, and function as an effective substitute to, the rural moneylender

The present financial position of the movement may be said to be fairly satisfactory Although overdues had been on the increase for a number of years, they have been on the decline in recent years, thanks to the high agricul-

(1) Sir M B Nanavati and J J Anjaria, *Indian Rural Problem*, page 199

tural prices The number of societies failing and the amount involved also provide an index of the solvency of the movement Invariably, the solvency of a society, depends on the solvency of its members and, therefore, with the return of conditions of agricultural prosperity, the position of the societies can be stated to have improved to a very great extent From the financial standpoint, therefore, the co-operative movement can hardly be pronounced to have been a failure

In considering the question of cheap and timely credit, we have to examine whether the credit obtained has been secured at a cheaper rate of interest than that charged by the moneylender and also whether the formalities that the borrower has had to observe are relatively less severe and less humiliating to those of the moneylender Judged from either of these points of view, the co-operative movement cannot be declared to have proved a complete success

It is true the Co-operative Banks and primary credit societies have, in recent years, tried to reduce the rates of interest on loans But even so, the rates at which the members of primary societies are able to obtain finance are still too high to make its use profitable The following are the rates of interest charged by primary societies in the various Provinces [1]

Province	*Rates per cent*
Madras	7½
Bombay	9 and 3/8
Sind	9 and 3/8 to 10 and 15/16
Bengal	12½
Bihar	8 and 3/8, 12½ and 15 and 5/8
Orissa	8
United Provinces	9
The Punjab	2 to 12½
Central Provinces and Berar	7
Assam	12½
N W F	12½

It is seen from the foregoing table that the rates of interest are still very high and as such the agriculturists can ill afford to pay

Secondly, the formalities that the agriculturist-borrower has to observe are of a nature which well nigh dissuades him from applying for a loan One of the chief defects of the co-operative movement is the delay in obtaining loans from societies In some areas, members have to wait for one to two months after applying for a loan

(1) Report of the Agricultural Finance Sub-Committee (1944), page 50

before they can get it At times, the agriculturist requires money at short notice, as, for instance, for his current agricultural needs, if the society cannot accommodate him promptly, he is perforce driven to the moneylender [1] In addition to the delay, according to competent people, the member borrower has to submit himself to cross examination like a criminal before a prosecuting Inspector, by the members of the managing committee The fact is that, in the rural societies, "the well-to-do form a distinct class, from the needy," and the control of the society invariably vesting in the former, they are rarely likely to realise the needs of the latter—the needy agriculturists

A further factor militating against the success of the co-operative movement is the lack of genuine co-operators In India, people with business interests, and other well-to-do persons make co-operative movement a "career" People who propagate co-operative principles should also practise them Where the private interests of co-operators conflict with their public mission, it is likely that the former will triumph over the latter

There are other drawbacks too The defective audit, the isolation of the Central Banks, the objectionable practices of the members of the managing committees, and the growth of party spirit among the members composing these societies have all tended to discredit the movement However, many of these defects can be remedied This can be done by the State taking an increased interest in the working of these societies It is not enough, if the State restricts its activities merely to registration and occasional supervision The Provincial Governments should nominate officers of the revenue and the agricultural departments of the villages on the managing boards of the village societies and constantly guide them with their advice and co-operation By means of this, it is seen, the Government can gauge, from time to time, the actual progress of these societies all over the Province

(1) Report of the Agricultural Finance Sub Committee (1944), page 49

CHAPTER V

RURAL CREDIT AGENCIES

LONG-TERM FINANCE—LAND MORTGAGE BANKS DEBT CONCILIATION AND REDEMPTION

While short-term credit can be provided to the Agriculturists by the rural credit agencies such as societies, long-term credit can be provided only by special institutions created for that purpose The ideal institution is the Land Mortgage Bank.

Generally, Land Mortgage Banks are associations of borrowers and non-borrowers created for the purpose of granting loans to members to enable them to redeem their past debts, for enabling them to make long-term improvements in their lands.

There are three types of Land Mortgage Banks.—

(i) the co-operative type,

(ii) the commercial type, and

(iii) the quasi-co-operative type

The strictly co-operative type is an association of borrowers who raise credit by the issue of mortgage bonds bearing interest and made payable to the bearer This type is represented by the Prussian Farm Mortgage Mutual Credit Associations, which are associations of borrowers They have no capital, and credit is created by issue of mortgage bonds payable to bearer and bearing interest The Federal Farm Loans Banks of the U S A are also illustrative of the co-operative type The second is the commercial type which works for profits and declares dividends Though the commercial type Land Mortgage Banks work as joint-stock concerns, the state exercises some measure of control over their operations in order to ensure that they do not cause hardship to borrowers and that they fulfil their obligations to their investors and debenture holders The Joint-Stock Land Mortgage Banks of European countries are examples of this type The third is the quasi-co-operative type Associations with membership of borrowers operating over fairly large areas and formed with share capital, with limitation of voting rights, irrespective of the shares held,

and working on a limited liability basis, are examples of this type What is found in India is the quasi-co-operative type The co-operative type has not fully developed here, "although there are substantial elements of the co-operative theory and practice in all these Banks"

The Land Mortgage Banks obtain funds from share capital and from other sources like loans from individuals and banks and societies, deposits and debentures The debentures may be subscribed by the public or by the Government The Reserve Fund and other funds also form part of the working capital However, the bulk of their capital is derived from debentures The Land Mortgage Banks in Madras, Bombay, the C P and Berar, Cochin, and Baroda have obtained their funds for working capital from debentures for which the respective Governments have guaranteed principal and interest to debenture holders These debentures, it may be noted, are classified as "trustee securities" In view of the difference of opinion between the Reserve Bank, on the one side, and the Provincial Governments and the Land Mortgage Banks, on the other, regarding the Government guarantee on the debentures over a long period (as the former considers that the guarantee should cease after a period to make the movement self-supporting), the question of recognising the debentures for the purpose of granting loans by the Reserve Bank is kept in abeyance [1] The Provincial Governments are also assisting them in other ways by supplying them with free services of valuation officers and other departmental officers and granting them subsidies in the initial stages in some cases [2]

Co-operative Land Mortgage Banks have not developed well in India The first Land Mortgage Bank was established in Jhang in the Punjab. Other banks were established in the Punjab later on But they did not make much progress The real beginning may, therefore, be said to have been made with the establishment of the central Land Mortgage Bank in 1929, in Madras Thereafter, other Provinces and States also established similar institutions Provinces like Madras and Bombay and Indian States like Mysore have Central Land Mortgage Banks in addition to primary Land Mortgage Banks The table on pp 36, 37, 38 illustrates the position of Land Mortgage Banks in India as at the end of the year 1942-43

217 (1) Sir M B Nanavati and J J Anjaria, *Indian Rural Problem*, page

(2) Report of the Agricultural Finance Sub-Committee (1944), page 54

OPERATIONS OF LAND MORTGAGE BANKS AND SOCIETIES DURING 1942-43

Province	Number of Societies	Number of Members	Share Capital paid up	Loans from (a) Individuals (b) Societies and Banks	Deposits	Debentures (p) Public (g) Government
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Madras	120	70,448	29,59,102	(b) 2,44,77,580	8,64,163	2,05,93,300
Bombay	18	16,214	8,61,314	(b) 33,40,122		(p) 31,76,200
						(g) 3,23,800
Bengal	10	2,799	56,889	(b) 5,54,750	6,525	
Orissa	1	852	64,154	(b) 20,000		(g) 1,25,000
United Provinces	5	869	32,132	(b) 82,681	78,650	
Punjab	10	3,855	84,272	(b) 5,63,000	11,939	
Central Provinces & Berar	21	6,985	1,26,518	(a) 84,984		
				(b) 12,39,582		
Assam	4	1,767	85,895	(a) 1,75,004		(g) 37,600
				(b) 600		
Ajmer Merwar	12	1,232	6,851	52,228	11,790	
Mysore	67	9,813	3,41,955	(b) 17,43,280		(p) 17,63,600
						(g) 19,800
Baroda	2	2,277	2,16,425	(b) 35,100	1,26,401	(p) 3,69,455
						(g) 1,30,750
Cochin	1	2,011	84,130			(p) 15,00,000
						(g) 82,198
Grand Total	271	11,19,782	49,19,967	(a) 2,59,988	10,99,558	(p) 3,64,02,535
				(b) 3,21,09,882		(g) 7,10,143

OPERATIONS OF LAND MORTGAGE BANKS AND SOCIETIES DURING 1942-43

Provinces	(r) Reserve fund (o) Other funds	Total working Capital	Loans made to (s) Societies and Banks (i) Individuals	Loans repaid by (s) Societies (i) Individuals	Loans due from (s) Societies (i) Individuals. (k) Overdues	Profits
	(8)	(9)	(10)	(11)	(12)	(13)
Madras	(r) 10,20,742	5,05,34,000	(s) 23,65,160	(s) 37,84,734	(s) 2 44,64,105	2,20,928
	(o) 6,10,104		(i) 24,81,849	(i) 37,94,374	(i) 2,50,50,049	
					(k) 71,549	
Bombay	(r) 63,100	77,87,280	(s) 3,94,370	(s) 3 43,351	(s) 31,34,879	60,847
	(o) 22,723		(i) 3,78,329	(i) 3,82,599	(i) 33,24,249	
					(k) 69,671	
Bengal	(r) 8,304	6,34,509	(i) 3,071	(i) 95,890	(i) 5,73 248	9,097
	(o) 8,041				(k) 22,407	
Orissa	(r) 3,664	2,19,108	(i) 74,357	(i) 11,593	(i) 1,97,567	3,321
	(o) 6,650					
United Provinces & Berar	(r) 7,232	2,07,757	(s) 24,702	(s) 18,018	(s) 11,161	5,423
	(o) 6,762		(i) 15,550	(i) 26,591	(i) 1,80,557	
					(k) 19 062	
Punjab	(r) 60,163	7,18,105	(s) 1,58,181	(s) 1,57,631	(s) 6,508	94,163
	(o) 19,731		(i) 10,051	(i) 2,44,701	(i) 5,29,125	
					(k) 2 09,830	
Central Provinces	(r) 19,468	14,81,457	(s) 5,04,945	(s) 5 04,062	(s) 1,84 705	20,594
	(o) 10,005		(i) 1,04,744	(i) 2,04,245	(i) 12 93 515	
Assam	(r) 25,102	3,82,275	(i) 3,850	(i) 9,231	(i) 2,50,850	11,304
	(o) 58,074				(k) 2,26,363	
Ajmer Merwar	(r) 6,626	74,183	(s) 7 330	(s) 7,718	(s) 2,155	1,507
	(o) 4,012		(i) 2,627	(i) 12,140	(i) 70,004	
					(k) 965	
Mysore	(r) 75,529	30,88,627	(s) 3,34,120	(s) 1,71,113	(s) 17,43,250	50,039
	(o) 39,513		(i) 3,42,047	(i) 1,79,971	(i) 17,94 414	
					(k) 7,940	

OPERATIONS OF LAND MORTGAGE BANKS AND SOCIETIES DURING 1942-43

Provinces	(r) Reserve fund (o) Other funds	Total working Capital	Loans made to (s) Societies and Banks (i) Individuals	Loans repaid by (s) Societies. (i) Individuals.	Loans due from (s) Societies (i) Individuals. (k) Overdues	Profits
	(8)	(9)	(10)	(11)	(12)	(13)
Baroda	(r) 19,643 (o) 43,000	9,40,864	(i) 44,950	(i) 1,05,292	(i) 7,27,148 (k) 38	22,148
Cochin	(r) 27,770 (o) 1,29,942	18,24,040	(i) 1,55,806	(i) 2,14,149	(i) 17,97,984 (k) 10,298	18,780
Grand Total	(r) 13,55,343 (o) 9,51,523	7,78,17,964	(s) 38,48,814 (i) 36,18,130	(s) 50,77,757 (i) 52,74,977	(s) 2,95,26,015 (i) 3,37,95,788 (k) 1,17,044	4,99,266

Land Mortgage Banks in India advance loans repayable within a comparatively shorter period than in other countries While the maximum period allowed for the repayment of such loans in India is 20 years, it is 30 years in Finland, 33 years in Chile, 36½ years in New Zealand, 42 years in Australia, 50 years in Italy and Japan, 54½ years in Austria, 57 years in Switzerland, 60 years in Denmark, 63 years in Hungary, 68½ years in Ireland, and 75 years in France [1]

Loans are generally granted upto a limit of Rs 5,000 in the case of individual borrowers According to the Report of the Central Banking Enquiry Committee, the societies in Bombay had power to advance loans upto 50 per cent of the value of the encumbered land, or, in special circumstances of house property, not more than ten times the value of their paid-up share capital in Bengal, and in Assam, the Kamrup and Sylhet Banks granted loans to the extent of only 50 per cent of the market value of the land [2] In the Madras Presidency, Banks situated in the Deltaic areas lend up to Rs 15,000 and others up to Rs 10,000

The rates of interest which Land Mortgage Banks pay on loans and deposits naturally differ from the rates they charge to the borrowers The rates in both cases differ according to Provinces and States The following figures show the rates for the year 1942-43 [3]

Province	Borrowings per cent	Lendings per cent
Madras	5	6
Bombay	5	6½
Bengal	5	8¾
Orissa	3½	7
United Province	5	7½
Punjab	4½	7
Central Provinces and Berar	5	7
Assam	6	9¾
Ajmer-Merwara	5½	8
Mysore	6	7
Baroda	2½	6
Cochin	4	6

The Land Mortgage Banks operating in the country are doing useful work and have met with substantial success But the development is still small as compared with

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 69

(2) Ibid , page 164

(3) Statistical Table relating to Co-operative Movement in India, 1941-42, 1942-43

the long-term finance requirements of the country. The business of the existing Land Mortgage Banks should be developed, wherever possible, with State assistance, if need be The rates of interest charged by these Banks are high and the agriculturists are not likely to make much use of their finance unless the rate is reduced to say 4 per cent which can be done by means of State subsidies [1]

Land Mortgage Banks in India advance loans only for the redemption of past debts, and it is suggested that they should also advance funds for the purpose of improvement of lands While it is true that they should advance loans required for long-term development of land, the slender resources of these Banks are hardly sufficient to advance for the liquidation of rural indebtedness of the immense magnitude that India's is, and it looks, therefore, inevitable that their activities should be limited to making loans for redemption of old debts

While Co-operative Land Mortgage Banks enable the ordinary agriculturist with limited means to pay off his old debt, the needs of bigger landlords can be met by the creation of Joint-Stock Land Mortgage Banks In fact, the Central Banking Enquiry Committee has recommended the establishment of such Banks.

II

DEBT CONCILIATION AND REDEMPTION

In providing long-term credit to the agriculturists to pay off their antecedent debt, the Land Mortgage Banks can serve only those who can offer some security and are able to save something out of their current income to pay off the instalments However, in a large majority of cases, the incomes of the agriculturists are hardly enough for their living, as agriculture in India is more or less a mode of living than a lucrative business The fact that there is need to borrow to pay off an old debt is in itself a sufficient evidence of the deteriorating position of the agriculturist A burden of debt in which there is a significant renewal of old debts cannot but have a dragging effect on the economy The problem of reducing the indebtedness of the peasants is, therefore, of the utmost importance Unless the agricultural economy is freed of the incubus of a heavy, accumulated debt, it will not begin to function normally, and as long as the charge on the current income

(1) Report of the Agricultural Finance Sub-Committee (1944), page 54.

of the producer on account of interest and repayment of old debts is not placed at a reasonable level,[1] any system or scheme of finance will not have a chance of successful operation It is, therefore, recognised that the adjustment of old debts must be brought in order to allow for the normal functioning of the economy of the producer and as a necessary preliminary to any organisation of agricultural finance that may be built up

Realising the gravity of the problem, no doubt, the Central Banking Enquiry Committee recommended that the Provincial Governments should appoint special officers to bring about voluntary conciliation by inducing debtors and creditors to agree to a settlement of the debt amount and for the repayment of such settled amount either immediately or by instalments within a definite period These payments may be made through co-operative societies, and, when payments are fixed by instalments, the instalment should be within the repaying capacity of the debtor without any burden on current productivity

Attempts made by the Provincial Governments were threefold, first they attempted conciliation, purely voluntary, by administrative orders, the next attempt was in the form of legislation for voluntary conciliation and reduction of the debt amount, thirdly, when these methods failed, they legislated for compulsory scaling down of debts.

Attempts have been made by Provincial Governments since 1890 to bring about an adjustment of debts In the Central Provinces, between 1890-1900, the local **panchayat** was used as the conciliation agency under the supervision of a Government Officer for this purpose The debtors and creditors were required to sign an agreement to abide by its decision, the creditors were asked to submit a statement of claims and sign a declaration that the statement was complete and that any claim not listed would be considered void. The debtor's paying capacity was taken into account in deciding the instalment amounts, and interest was allowed only on overdue loans at 6¼ per cent for cash loans and 12½ per cent for grain loans However, no special agency was created to redeem the compounded debts The total debt conciliation during the period amounted to Rs 206 29 lakhs, and the amount remitted was Rs 121 71 lakhs Similar attempts were made in Ranchi in Orissa during 1906-12 by the Government to redeem the mortgage debts of the cultivators who were not beyond

(1) Report of the Agricultural Finance Sub-Committee (1944), page 17.

redemption by advancing loans at 6¼ per cent, the loans to be repaid by instalments over a period adjusted in relation to the amount of debt and the value of the debtor's holding.

Co-operative Societies and Land Mortgage Banks also tried to adjust old debts as far as possible. But these attempts were small compared to the magnitude of the problem

Apart from the adoption of administrative measures to adjust debts in the Central Provinces, attempts were made in other Provinces to bring about voluntary conciliation of debts by legislative measures. The most significant of such measures was the Deccan Agriculturists Relief Act of 1879, passed in Bombay This Act authorised the Courts, **inter alia**, to examine the history of the debts, take an account of interest, and to spread the amount actually due over a number of instalments For the first time, legislation was enacted for the creation of a Debt Conciliation machinery. It enabled debtors and creditors to apply to the conciliators, to be appointed by the Provincial Governments, to effect an amicable settlement of the debt It was, however, found in practice that many moneylenders secured a place on the Conciliation Boards and always had the upper hand in them In many cases the conciliators themselves colluded with the creditors, and certified agreements (which the courts had no power to reject) favourable to the latter were concluded, with the result that the purpose of the Act was nullified. In many cases, no conciliation could be effected The provisions relating to conciliation were therefore repealed in 1911 [1]

But the attempts to relieve the peasant was not abandoned The Contract Act was amended so as to empower Courts of Law to give relief to debtors in cases of unconscionable bargains, on proof of undue influence, or where the bargain confirmed any stipulation by way of penalty It was of little effect "In a country where the moneylenders are mostly men of education and intelligence and where the majority of agriculturists are generally ignorant and illiterate, it is extremely difficult to prove undue influence. It is equally difficult to prove that the bargain is unconscionable"

The simple agriculturist or artisan is so severely pressed for accommodation that he has no free will at all, and

(1) Report of the Agricultural Finance Sub-Committee (1944), page 18

ignorant that the rate of interest could be lower than the prevailing usurious rate cheerfully agrees to the exorbitent terms offered [1]

The Usurious Loans Act (1918) was applied empowering the Courts to provide relief against excessive rates of interests Even this measure failed, and failure was mainly due to reasons like the uncertainty of the provisions of the Act, the difficulty of proving what was an excessive rate of interest, and, finally, the difficulty of proving undue influence The defect of the Act was that, unless the debtor pleaded the Act, no court was bound to interfere The debtor, in the absence of an alternative agency to offer credit facilities, rarely invoked the aid of the Courts The rule of **Damdupat** was applied in some Provinces, and, in some Provinces, the decision of the High Courts nullified the benefits of the provisions to the debtors In some Provinces, Land Alienation Acts were passed protecting the lands of the borrowers from passing into the hands of the moneylenders

These attempts were made only here and there and offered no substantial relief to the debtors With the coming of depression, the plight of the agriculturists became still more precarious Fortunately, the State intervened to tackle this problem afresh Several Provinces afforded relief by passing Acts to reduce the rates of interests and to protect the property of the debtors against attachment by creditors and even by easing the laws of insolvency These proved ineffective, particularly because of sentimental objection by the debtors against being declared insolvents

The Provincial Governments also passed legislative measures to afford real relief to the indebted peasantry * Most Provinces like Bombay, Madras, Central Provinces and Berar, Bengal and Assam passed Debt Conciliation Acts providing a machinery for debt conciliation and settlement Under these Acts, Debt Conciliation and Settlement Boards were set up in each Province for the amicable settlement of debt amount and its repayment by the debtors to the creditors

The method adopted was one of voluntary conciliation A debtor as well as a creditor could apply to the Board for the adjustment of the debts On the receipt of the application, the creditors were asked to submit their claims

(1) Bengal Banking Enquiry Committee Report, page 164

* For an illuminating discussion on Debt Legislation see, N G Abhyankar's *Provincial Debt Legislation*

with the condition that a claim not listed would not be considered later on. The debtor would also be asked to submit details of his debts, his assets and liabilities The Conciliation Board would hear both the parties and witnesses, if any, and, thereafter would reduce the terms of settlement into writing In the Central Provinces and Berar, the Punjab, Bengal, and Assam, the terms were to be reduced into writing only if creditors to whom 40 per cent of the debt was owing agreed to it, while the Madras Act provided that the terms of settlement could be reduced into writing only if creditors to whom 50 per cent of the debt was owing agreed to it. The Bengal Act further provided that where the debtor was unable to pay the reduced amount within 25 instalments, the Board may declare him an insolvent In some Provinces in order to induce the creditors to agree to conciliation, priority was given to adjusted debts in the matter of payment over others, these debts, particularly defaulted instalments, being recoverable as land revenue [1]

In many Provinces, the Acts required that, where a fair settlement was brought about by the Board between the debtors and creditors and the creditors were not agreeable to such reasonable settlement, the Boards were empowered to grant a certificate by which the creditors were prevented from claiming a higher rate of interest than 6 per cent from the date of the settlement, and, in some Provinces the Acts denied costs altogether in addition in a suit by the creditors against the debtors The Sind Conciliation Act further provided that the claim of the refusing creditors for the payment would be postponed until the moneys due to the settled creditors were paid

The awards of the Debt Conciliation Boards were final and could not be called into question in any civil court However, Boards were allowed to review their decisions, and, in some Provinces, appeal was provided to the Collectors against the decisions of the Boards

The working of the Debt Conciliation Boards has not yielded successful results in all Provinces, though, in some Provinces, they have been a substantial success In some Provinces the debtors have received substantial relief Thus in Bengal, till the end of March, 1944, a total debt of Rs 5,016 02 lakhs have been scaled down to Rs 1,796 28 lakhs representing a reduction of 64 per cent In the Central Provinces and Berar, the Boards were able to settle debts amounting to

(1) Report of the Agricultural Finance Sub-Committee (1944), page 21.

Rs 1,561 02 lakhs to Rs 774,85 lakhs, that is, to an amount little less than 50 per cent Similarly, in the Punjab, during one year 1939-40, debt of Rs 91 45 lakhs was reduced by Rs 55 6 lakhs The Relief Courts established in Madras, in addition to Debt Conciliation Boards, and the Relief Courts established in Central Provinces superseding the Conciliation Boards scaled down claims of Rs 931 21 lakhs and Rs 428 09 lakhs to Rs 444 00 lakhs and Rs 299 8 lakhs, respectively [1]

However, some Provincial Governments, for the first time, abandoned the voluntary method and legislated for compulsory scaling down of debts In the Central Provinces and Berar, the Debt Conciliation Boards were abolished by replacing the Debt Conciliation These measures were inadequate, for they did not aim at a permanent solution of the chronic problem of agricultural indebtedness The defect of the machinery employed was patent, in that the conciliation procedure was purely voluntary Even in Provinces where Debt Relief Courts were functioning, unless the debtor invoked their aid, nothing could be done Perhaps the greater reason for the failure of these efforts was that as there was no alternative credit agency available to finance the current needs of agriculturist, he was not willing to antagonise the moneylender by approaching Debt Conciliation Boards or Debt Relief Courts for relief and assistance Moreover, the jurisdiction of the Boards in several Provinces was limited to debts below a certain maximum varying from Rs 500/- in Assam to Rs 50,000/- in the Central Provinces In some Provinces, debts below a certain amount were altogether excluded from their jurisdiction

In addition to these attempts made, the Provincial Governments in recent times have passed legislation for the compulsory adjustment and scaling down of debts In the Central Provinces and Berar, the Debt Conciliation Boards were abolished by replacing the Debt Act of 1933 and Debt Relief Courts were set up in their place by passing the Relief of Indebtedness Act, 1939, to deal with all new applications that might, in future, be preferred to the Courts The method of conciliation adopted hitherto was abandoned and the courts were empowered to review debts both in respect of principal and interest, subject to the Law of **Damdupat** and the Usurious Loans Act Under the Act, the Courts in the Central Provinces reopened all transactions made 12 years before the last transaction or before

(1) Report of the Agricultural Finance Sub-Committee (1944), page 23

1st January 1932 whichever was earlier, and ascertained as far as possible the date on which each loan was originally advanced The Courts reduced the principal amount by 30 per cent if the debt was incurred on or before 31st December, 1925, by 20 per cent if between 31st December, 1925 and 31st December, 1929 and 15 per cent if between 31st December, 1929 and 31st December, 1931. Where the debtor had transferable property and was willing to transfer his property to his creditors in lieu of the debt either in part or whole, the Court could sanction such transfer on such conditions as it thought necessary to safeguard the interests of the secured and unsecured creditors Where the debtor had no heritable or transferable property, the Courts fixed the instalments for the repayment of the balance on the basis of the debtor's paying capacity

The Bombay Agriculturists Debt Relief Act of 1939 was also passed with the object of compulsorily scaling down the debts, not exceeding Rs 15,000, of cultivating agriculturists by means of Debt Adjustment Boards of the area created for this purpose

Under the Act, every debtor, failing that every creditor on the pain of the debt being deemed to have been discharged had to apply to the Board within a stated period for the adjustment of debts Other creditors like Government, Local bodies and Co-operative Societies were required to intimate to the Board the amount they were willing to remit In regard to other debts, the Board was required to apply its judgement and set aside all unconscionable dealings and declare a fair amount. It was also laid down that, for loans incurred before 1st January 1931, separate accounts as to principal and interest were to be made upto 1st January 1931 and the principal and interest were each to be reduced by 40 or 30 per cent according as the loan was advanced before 1st January 1930 or between 1st January, 1930 and 1st January, 1931. In cases of loans incurred in the latter period interest was to be reduced according to the prescribed schedule The aggregate amount due was to be arrived at from the reduced amount in the following manner —

(a) If the total amount of the secured debts of a debtor found due is less than 80 per cent of the value of his immovable property (excluding the property acting as cover against Government obligations or exempted from attachment or sale under the C P C) the difference between the

amount of the debt and 80 per cent of the value of the property

(b) 80 per cent of the value of the immovable property not subject to the liability of the secured debt, and

(c) 80 per cent of the value of other assets

After assessing the debtors' paying capacity, the debts are to be reduced and payments arranged as follows

(a) If all the debts are unsecured, they are to be reduced to the debtors' paying capacity

(b) If all the debts are secured and their total exceeds 80 per cent of the value of the debtor's property they are to be reduced to 80 per cent of such property

(c) If the debts are both secured and unsecured and the secured debt exceeds 80 per cent of the value of their security, the secured debt is reduced to that figure and the unsecured debt is reduced to 80 per cent of the value of the remaining property

After calculating the amount due by the debtor, the Board is empowered to make an award for repayment of the debt by instalments not exceeding 25 in number and each instalment not more than the net annual income of the debtor, the net annual income being the residue left after making deductions for himself and his dependents and for payment of loans borrowed for financing the crops and of debts due to Government and local authorities Any private settlement between the debtor and the creditor was declared void, unless it was intimated to the Board within 30 days for certification by the Board if the Board was satisfied that it was in the interest of the debtor The Act also provided that, where a creditor agreed to reduce his debt to 50 per cent of the value of the immovable property of the debtor, he had the option to receive his reduced debt amount in the form of bonds issued by the Bombay Provincial Land Mortgage Bank and guaranteed by the Provincial Government

The Madras Agriculturists Relief Act (1938) also was another piece of this kind of legislation It provided that no interest could be claimed on debts outstanding on 31st October, 1937 and that only principal shall be considered as due, and, secondly, where the debtor has been paid twice the amount of principal as interest, he shall be deemed to have paid the whole of the debt due, but, if the amount falls short of twice the amount of principal, then the

amount of such difference alone shall be payable As far as debts incurred after October, 1937 went, the Act provided *for their scaling down, calculating the interest at* 5 per cent and then, if the scaled down debt is not paid, interest shall be calculated at $6\frac{1}{4}$ per cent. or at the rate *to be fixed by the Provincial Government*

The U P Agriculturists Debt Redemption Act of 1939 also was passed with a similar end in view Under the Act, the courts of Law were empowered to award, by way of the principal amount due, a sum not exceeding twice the amount of the principal after deducting all payments made to the creditor in the past in respect of such transactions

Some Indian States like Mysore, Hyderabad, and Bhavnagar also have passed similar legislation and set up Debt Conciliation Boards The most striking success has been attained in Bhavnagar, where the debts, on being settled and very greatly scaled down, were taken out by the State who have paid off the creditors.[1]

But, in the Provinces, the measures taken failed to achieve the desired objects The Agricultural Finance Sub-Committee (1944) has made the following recommendations for the successful working of Debt Conciliation Boards —

(1) The work of adjustment should be entrusted to judicial officers or boards adequately manned by judicial officers and decision of such Boards should be final

(2) The work of adjustment should be completed within a specified time, which should not exceed two years

(3) In order to determine the fair amount due from a debtor, the adjustment agency should scrutinise each account and go behind the entries, as is provided in the Usurious Loans Act and the Deccan Agriculturists Relief Act

(4) The amount determined as fair should be reduced to the present value of the debtor's normal repaying capacity over 20 years worked out at a rate of 4 per cent interest or to 50 per cent of the normal value of his immovable property assets, whichever is less, provided that (a) a secured debt is not reduced to less than 50 per cent of the value

(1) G. B Jathar and S G Beri, *Indian Economics*, Vol 1, page 276

of the property on which it rests, (b) and the proportion allowed of a secured debt in terms of the value of the property on which it rests is not smaller than the proportion allowed of the unsecured debts to the total of such debts

If the debtor has not hereditary or transferable rights in land and his debts fairly determined exceed his total paying capacity by a given proportion to be prescribed in Law, the Board should adjudge him an insolvent to be dealt with compulsorily under a simple insolvency procedure

In the case of all other debtors, the adjusted debt should be awarded to be paid to creditors (including Government and Co-operative Societies) immediately in lump, by borrowing from a Land Mortgage Bank or a Governmental agency set up for the purpose

The agency taking over the debt will recover it from the debtor in instalments spread over a period not exceeding 20 years

The Committee has suggested the creation of an Agricultural Credit Corporation for providing the agriculturist all types of credit Its suggestion that the debt should be paid off by the Land Mortgage Banks or the agency to be created for that purpose deserves the greatest attention '

No permanent solution of this chronic problem can be achieved, unless attempts are made to pay off the creditors in a lump sum, even if the debts are scaled down to 50 per cent The Provincial Governments should take over these debts after due enquiry and reduction of debts and pay to creditors and recover from the debtors by annual instalments along with land revenue Where the debtors have no heritable and transferable right, then that amount must be written off If the success of the attempts of Bhavnagar State shows anything, it is that the State can achieve any object if only it has the will

* See Appendix I for recent Debt Legislation in Bombay

CHAPTER VI

RURAL CREDIT AGENCIES

COMMERCIAL BANKS, INSURANCE COS., LOAN OFFICES, NIDHIS, CHITFUNDS, AND THE GOVERNMENT

As a general rule, commercial banks do not finance the agriculturist directly, but they finance indirectly the movement of crops by granting loans to merchants, middlemen, and exporters They also discount **hundis** for merchants drawn for the marketing of crops The Imperial Bank and the other Commercial Banks make advances to bigger merchants, commission agents, and exporters on the security of crops However, none of these agencies finance the agriculturist directly, and the consequence is that he has no option but to go to the money-lender. "Although Join-Stock Banks are lending against agricultural produce to a greater extent than before, they do so only against the produce which has already left the hands of the producer and has come into the hands of the trader, the middlemen in the market.[1] Even here there are no figures to show the extent to which commercial banks finance agricultural marketing However, statistics recently collected by the Reserve Bank of India show that of the 39 Scheduled Banks which had advanced against agricultural produce, 38 banks had advanced Rs 22 17 crores on 31st December, 1942, while the remaining one bank had advanced Rs 11 58 crores on 31st December, 1943 The rate of interest on these advances was usually 6 per cent, though, in certain cases, it was as low as 2½ per cent while, in other cases, it was as high as 10 per cent[2] Considering the great magnitude of the problem and the important place of agriculture in the national economy, the role of the commercial banks as reflected here is insignificant indeed Even in a highly industrialised country like England, the importance of agriculture was never lost sight of In addition to the various organisations the advances made by the commercial banks was substantial The Committee on Agricultural Credit in England (1923) ascertained

(1) Report of the Co-operative Planning Committee, Minute of Dissent by M R Bhide and S Hasan, page 196

(2) Report of the Agricultural Finance Sub-Committee (1944), page 56

from each of the five leading banks in England and Wales the precise extent of their loans to agriculturists and found that a sum of £. 46½ millions represented the loans outstanding against farmers, of which £ 26 millions were loans for the purchase of land and £ 20 millions normal loans for current trading [1] But in comparing conditions in the two countries, we must not overlook the fact that the commercial banks in India are in a peculiarly difficult position The rapid circulation of money being essential to the success of a commercial bank and the bulk of its working capital being derived from short-term deposits or call money, a commercial bank cannot, generally speaking, postpone its recoveries or tie up its resources to accommodate the farmers' needs [2] However, a more cogent reason why commercial banks do not seem to take to advancing on agricultural produce on a large scale is that they probably make a greater margin of profit in their ordinary business involving short-term accommodation than advancing to the agriculturist on his produce Moreover, not all banks have branches both in the interior in the assembling centres and in the Port towns, so necessary for undertaking this business Notwithstanding these handicaps, the fact still remains that there is greater scope for commercial banks in this field, particularly because the Reserve Bank is authorised to rediscount the bills endorsed by them and drawn for the marketing or financing of crops *

Insurance Companies take very little or no part in agricultural finance. In the main, their loan operations consist of advances against the security of life policies But some insurance companies take indirect part in agricultural finance by taking up the debentures of Land Mortgage Banks At the close of 1944, for instance, the investment of insurance companies in the debentures of the Madras Central Land Mortgage Bank, the Bombay Provincial Land Mortgage Bank, and the Central Provinces Provincial Co-operative Bank amounted to about Rs 32 84 lakhs [3]

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(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 48

(2) Ibid., page 47

* Commercial Banks' loans to agriculture

(Figures in 000,000 dollars)	Year 1938	Year 1943
U S A	712	1023
Canada	148 5	295 8

(3) Report of the Agricultural Finance Sub-Committee (1944), page 55.

There are other institutions like the **Loan Offices** of Bengal, **Nidhis**, and **Chit funds** of Madras which also take part in agricultural finance, and a brief reference to these may be made here

Loan offices are peculiar to Bengal They occupy an intermediate position between indigenous bankers and joint-stock banks The number of these loan offices increased enormously after the World War I and their number at present is placed at 1,000, with working funds of about Rs 9 crores [1] They rely for their funds entirely on deposits received from the public, particularly, from the middle class people, and they pay interest on these deposits at rates varying from 4 to 8 per cent depending upon whether the deposits are short-term or long-term in character They generally lend to **Zamindars** (which they may not be able to continue for long, as the liquidation of the **Zamindari** system is only a question of days now) or their tenant cultivators against mortgage of land, pledge of ornaments and even against personal security The purpose of the loan is immaterial to them

The Central Banking Enquiry Committee has suggested that these loan offices working on a joint-stock basis should be subjected to a special Bank Act, and other loan offices should be regulated by passing a Bengal Loan Office Act, that they should maintain proper books of account, maintain adequate reserves and make provision for proper auditing etc It was also suggested by the Central Banking Enquiry Committee that these Loan Offices should be granted financial assistance from the Loan Offices Financing Corporation to be established for that purpose.

Nidhis and **Chit funds** are institutions found in the Madras Presidency They are indigenous institutions, some of which are registered under the Indian Companies Act There are at present 228 of them all registered under the Indian Companies Act, five as Banks and the rest as **Nidhis.**[2] Their business is to promote savings, to relieve the members from old debts and deliver them from usury and give them loans for all purposes and to accumulate a fund for special loans They grant loans even to outsiders and not necessarily always for productive purposes

The next important agency dealing with agrarian finance is the Government itself In spite of the various private agencies like the moneylender, the co-operative

(1) S G Panandikar, *Banking in India*, page 119

(2) Ibid., page 123.

societies, and the Commercial Banks the importance of State aid to agriculture cannot be minimised The Land Improvement Act of 1871 and the subsequent Land Improvement Act of 1883 definitely accepted the principle of the need for Government undertaking finance of agricultural improvements These Acts empowered the Provincial Governments "to make rules as to loans to be made to owners and occupiers of arable land for the relief of distress, the purchase of seed or cattle or any other purpose connected with agricultural subjects" The Agricultural Banks contemplated at the time of passing these Acts never came into existence The Government assistance has now taken the form of the grant of Takavi loans * Even the system of the grant of Takavi loans has serious defects "such as high rate of interest, rigidity of collection, onerous terms regarding the periods of payment, delays in distribution and conditions relating to securities required, etc [1] Apart from the inadequacy of the financial assistance the system has not been working properly

The Punjab Land Revenue Committee was of the opinion that the unpopularity of the Government Loans was due to the petty exactions of the subordinate revenue officers, the delay in obtaining money, the necessity of repaying on a fixed date, the failure of revenue officers to take any interest in the grant of loan, and little account being taken of harvest conditions and the borrower's ability to repay when the instalment was due In order to overcome this difficulty and to ensure the smooth working of the scheme of Government loans, the Famine Commission had recommended as early as in 1880 that the distribution of these loans should be through the Agricultural Department The Central Banking Enquiry Committee, after studying the whole question, observed that the operations of the Agricultural Loans Act should be generally restricted to relieve distress and added that the grant of advances under these Acts should not replace assistance for famine relief [2] The Committee had no objection to Government using co-operative societies for distribution of these loans, but observed that the societies should not be responsible for watching the application of the loans or its recovery

* On an average, about 95 lakhs of rupees are granted every year by the Indian Government in the form of *Takavi* advances, Rs 35 lakhs under the Land Improvement Act, and Rs 60 lakhs under the Agriculturists' Loan Act (Sir M B Nanavati and J J Anjaria, *Indian Rural Problem*, page 186)

(1) Report of the Irrigation Commission, page 32

(2) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 185

In recent years, some Provincial Governments have sought to improve the machinery, and, in Province like Madras, loans under the Agricultural loans Act are granted for the repayment of the old debts Not all these measures, however, have offered any real relief to the producer.

II.

The financing needs of agriculturists have been discussed earlier, and we have seen how the various agencies providing short-term and long-term credit are working But no account of agricultural finance will be complete without a reference to the agencies concerned with, and the character of, marketing finance In a broader sense, marketing finance means the finance provided by all agencies for moving the goods from the cultivator to the consumer or to the exporter In a narrower sense, it means a study of the agriculturist, vis-a-vis the present financial facilities available to him, at the time the goods leave his hands. It is well known that the agriculturists have no holding capacity, and that they, therefore, sell the crops immediately after the harvest at any rate prevailing The buyer is either a moneylender or an agent of the exporting firm if the commodity is a cash crop The result of the transaction between the producer and the moneylender merchant or the commission agent is too well known to need a special recapitulation here

The question of financing the movement of crops consumed within the country can be easily solved by the co-operative sales societies In fact, co-operative marketing societies have worked with substantial success in the Madras Presidency At the end of 1944-45, there were 181 marketing societies in Madras which issued loans to the extent of Rs 121 32 lakhs and sold agricultural produce such as cotton, groundnuts, potatoes, areca nuts, pepper, cardamom and paddy to the value of Rs 100 62 lakhs [1] These figures do not, however, give any idea as to relatively better price that the individual seller may have got over the prevailing market rate by relying on these societies in preference to the village monelyender or the commission agent of a foreign firm

"But, as regards the crops that are to be exported, there is no remedy for these evils until orderly marketing is established" Now, the agencies that finance the movement of crops are the moneylenders and indigenous

(1) W. R. Sattianathan and J C Ryan; *Co-operation*, page 22

bankers, commercial banks, the Imperial Bank, Agencies of export firms, and the Exchange Banks

When the moneylender purchases, he pays cash out of his small capital Sometimes, he borrows from merchants from towns and commission agencies

During the next stage, when the produce reaches the hands of the merchant, and till it reaches the exporter, the help of the Banking Agency is sought. The transactions involved are financed by drawing **hundis** supported by Railway receipts which are discounted with the indigenous bankers or joint-stock banks or the Imperial Bank of India In certain produce-assembling centres, the Imperial Bank and some commercial banks advance on the security of the produce stored in the godowns of big merchants From the financial accommodation thus secured, these merchants make further purchases The merchants either deliver the goods to the agent of exporting firms then and there, or they rail to port towns, and, on the basis of the relevant railway receipts, supported by other documents, they draw **hundis** and receive their moneys It is generally for 90 per cent of the value of the produce It is thus clear that banking aid is available only to merchants, and producers have no such facilities generally.

With a view, therefore, to provide an effective agency to enable the agriculturists to get financial facilities, the Central Banking Enquiry Committee recommended the establishment of co-operative sale societies and construction of godowns, so that agriculturists may store in these godowns and get financial accommodation on the security of such warehouse receipts

In recent years, a large number of co-operative sale and marketing societies have been established in India A marketing society consists of agriculturist-members who agree to sell their produce through it They also become shareholders of such a society The society is usually located at a market town It stores and sells the produce of its members When members desire to wait for a favourable rate, the societies wait and then sell From the time the society stores the produce till the time it sells, the societies offer substantial sums by way of advances to be adjusted later, after the sales are over The produce is sold either by public auction or by written tender. In markets where merchants do not like the system of tenders or auction, the produce is sold by private negotiations after obtaining the consent of the producer-owners

In the Madras Presidency, a system of "controlled credit" has been introduced Under this system, the credit society is linked with the marketing society. The credit society grants loans to the producers on the condition that they sell the produce through the marketing society. The marketing society sells the produce and, by this method, producers are sought to be benefited.

There are, as already stated, no statistics to show how exactly a member selling through the society has been able to receive a higher price than the price he would have got under conditions of free competition The views of some competent people on the working of these societies on the other hand, make a sorry tale It is true that the marketing society advances funds to the producers and stores their produce, but the question is, when it has to sell, where will it sell? It will sell in the local market, for the society cannot export, nor can it send to another Province for sale To whom else then has it to sell? It has perforce to sell only to local traders or to local agents of exporting firms It is a truism to say that these societies have members of conflicting interests In other words, not only agriculturists are members but there are trader-members as well The control of the Society has passed on to the latter, who, as members, influence the policy of the society both in the matter of the grant of advances and in determining the selling policy The consequence is that the price that producers obtain is only at the local rate as determined by the supply and the demand conditions created by the local traders In these circumstances it can hardly be said that the producers have benefited by the existing arrangements

Reorganisation of marketing Societies—Need for linking them with different and wider markets.

What is required, therefore, is to link the rural marketing society with a wider market so as not to restrict its activities to the local market A network of marketing societies will have to be started in each village to deal in different commodities These societies might be federated into a Provincial Marketing Society, which may be permitted to export the produce and to deal with markets in other Provinces The local marketing societies should act as mere acceptance houses On receipt of goods at their godowns, they should advance moneys to the

peasants The produce might be pooled at the godowns of the Provincial marketing societies at the port towns or at market towns The Provincial marketing society should conduct orderly marketing by spreading the sales throughout the year, and, on the goods sold locally or shipped to foreign countries, the producers should be paid the full value, of course after taking its commission for its labours Incidentally, this will enable the society to take advantage of the facilities offered by the Reserve Bank through the Provincial Marketing Society For it is then that the credit facilities offered by the Reserve Bank would reach the actual producer

By linking the rural marketing society with a wider market, India would be following the example of co-operative marketing societies of the European countries [1] Co-operative marketing societies of most of the European countries undertake export and thus enable their peasants to realise a higher price for their produce In regard to Iceland, it may be mentioned that the Federation of Icelandic Co-operative Societies is responsible for 80-90 per cent of the Country's exports of agricultural commodities. Co-operative organisations in Bulgaria handled as much as 21 per cent of the national export of the grapes In Hungary, the beekeepers societies used to account for over 60 per cent of the total honey exports of the country In Denmark 50 per cent of the butter exports were handled directly by co-operative organisations

If the Co-operative Marketing Societies of European Countries are able to place their agricultural products on the world market, we fail to understand why their example should not be followed by co-operative marketing societies in India, for the benefit of the Indian producers

(1) For an interesting account on 'Co operative Marketing' see *The Co-operative Movement and Present-day Problems* published by the International Labour Office, pages 25-28

CHAPTER VII

INDUSTRIAL FINANCE

Industrialisation of a country is desired, first, to make the country independent of foreign countries in the matter of its requirements as far as possible and, secondly, for the purpose of creating additional employment of labour by mobilising the dormant resources In India, the development of industries has a special significance, in that the country, being largely agricultural in character, it is necessary to divert a part of the population, which to-day depends on agriculture which the latter cannot support, towards industries, thus relieving the pressure of population on agriculture This can be achieved by rapid industrialisation Industrial development is also necessary in the national interest, for in times of war, the country cannot depend upon other foreign countries

The industrial policy of the State in India has so far been one of indifference In fact, it was one of the common complaints of the early writers on Indian economics and politics that the State in India did nothing for developing industries in India However, a large number of industries have come into existence in India in spite of this indifference of the State This is mainly due to the enterprising spirit of the individual entrepreneurs The cotton industry in Bombay owes its origin to the initiative of the early founders of industry—the managing agents In other countries of the world too, the development of industries during the earlier years of the Industrial Revolution was the working of individual entrepreneurs But the State intervened at a certain stage when the industries could not bear foreign competition and protected such national or domestic industries by constructing tariff walls In certain other countries, like Japan, the State offered positive help by means of subsidies and other financial assistance to enable the industries to develop

In contrast with the Governments of other countries the Indian Government is slow to move, though it must be said to its credit that it has protected a few industries by recognising the principle of "discriminating protection" Still it is considered that the industrial development of the country is not commensurate with the untapped in-

dustrial potential and the home market for these industrial products The index to such is the extent to which we are importing essential goods which we can manufacture in India If we are still obliged thus to import a large quantity of goods which we can produce in our own country, then our industrial development is meagre and leaves much to be desired The question of price of the imported goods, as compared to the domestic cost of production for the same commodity, has a bearing on the exports and imports of a country, but, generally speaking, the exports-imports statistics can be taken as an index of the industrial development

Industries are generally classified into major or large-scale industries and minor or cottage industries according as they involve large and complicated methods of production or small and simple processes Of the major industries, certain industries constitute key or defence industries, and the question of finance for such industries hardly arises, for it is the sole concern of the State In other words, the problem of industrial finance reduces itself to that of catering to the financial requirements of industries other than "Key Industries", as also the cottage industries

Industries in India are known to be suffering from want of suitable and adequate fincial facilities The Industrial Commission (1918) and the Central Banking Enquiry Committee (1931) have both emphasised this fact In fact, the Industrial Commission recommended the establishment of Industrial Banks and the Central Banking Enquiry Committee recommended the establishment of an Industrial Corporation, as we shall presently see

The financial requirements of industries may be classified into (1) Block Capital and (2) working capital

(1) Block Capital is required mainly by newly started industries for financing the *purchase* of fixed assets, such as land, buildings, machinery and other appliances of a durable character In the case of already established industries, block capital may be required for the purpose of extension and replacement The capital invested thus is more or less in the nature of a permanent investment

(2) Working Capital, on the other hand, is required for the purpose of processing the raw-materials into finished products, for purchase of raw materials and stores, for expenses incidental into marketing, and for meeting the day-to-day requirements

The question of industrial finance has been the subject of many commissions and committees As far back as 1916-18 the Industrial Commission emphasised the difficulties of medium-sized industries owned by middle class entrepreneurs and recommended the establishment of industrial banks Pending the establishment of such banks, the Commission recommended that joint-stock banks should finance middle class industrialists by advancing loans to them subject to a guarantee by the Government after an investigation by the Director of Industries and his expert staff in regard to the financial standing of the applicants and the prospects of the industry Accordingly, several Provinces like the Punjab, Madras, Bihar, and Orissa and Indian States like Mysore passed State Aid to Industries Acts But the financial help rendered under these Acts proved inadequate

The question of financial requirements of industries was considered at length by the Central Banking Enquiry Committee While some witnesses said, in their evidence before this Committee, that industries were not getting adequate finances either for the block capital or for the working capital, others were of the opinion that industries floated on sound lines had no difficulty of obtaining the financial assistance necessary In fact, according to the opinion of the former, the method of getting the capital by means of shares and debentures was highly unsatisfactory Among the difficulties which they mentioned were that the public in India preferred to invest their savings in postal savings account, port trust and Government Loans in preference to shares and debentures of private companies In so doing, the people were solely guided by factors of safety and liquidity. A portion of the national savings was invested in building activities and precious metals This was partly due to lack of public confidence in the industrial management and partly to the failure of certain concerns In these circumstances, the industries found difficulty in mobilising the capital required Until recently even debenture capital was not forthcoming unless higher rates of interests were offered The lack of market for first class debentures, the lack of agencies to educate the investor in regard to investment, and the absence of underwriting and issue houses to facilitate sale or transfer of these industrial scripts from one hand to another were further impediments To this may also be added the general poverty of the masses leading to shrinkage in the capacity to save and hence in the total

quantum of public savings The only agencies which could afford capital to industries were the prosperous business firms and corporations, insurance companies, and charitable institutions and trusts, etc

The Managing Agency system:

The consequence has been that the early pioneers of industry had to develop what has come to be known as the Managing Agency system The system is peculiar to India and unknown in western countries The Managing Agents are generally the promoters of a concern and they take the risk and responsibility for setting up the industry They furnish block as well as working capital, though, in recent years, large portion of the capital is collected by means of public subscription to shares of companies floated by them The cotton textile industry in Ahmedabad and Bombay owes its existence to the efforts of the managing agents These early founders of textile industry supplemented their own resources by means of deposits received from the public The following figures are quoted by the Central Banking Enquiry Committee regarding the share of deposits of the capital resources of the textile industry in Bombay and Ahmedabad

(Figures in lakhs of rupees)

	Bombay Figures for 64 Mills		Ahmedabad Figures for 50 Mills	
		%		%
Amounts loaned by Managing Agents	5 32	21	2 61	24
Amount loaned by Banks	2 26	9	4 12	4
Amount of public deposits	2 73	11	4 26	38
Share capital	12 14	49	3 40	32
Debentures	2 38	10	8	1

It was brought to the notice of the Committee by witnesses that the system of deposits, though beneficial, was precarious, in that the depositors might ask for withdrawal any time thus rendering the position of industry extremely uncertain The Central Banking Enquiry Committee, therefore, recommended that the deposits taken by the Cotton mill industry from the public should be gradually replaced by shares and debentures

The Managing Agency system has, however, certain drawbacks in spite of its immense usefulness It was found in practice that some Managing Agents, not being directly interested in the capital which was subscribed by

the public, mismanaged the affairs of the company and brought the company and the shareholders to loss In many cases, the managing agency became a family affair, as the rights of managing agency were heritable (before 1937) and the shareholders had no voice either in the management or in the matter of formulation of policies Where one managing agency firm managed one or more concerns, it was found, in practice, that the funds of one concern were invested in another Sometimes, the managing agents, who had advanced funds to the concerns under their management, converted their loans into debentures and became debenture holders The Managing agency firm invariably received commission both on sales and purchases for the concerns under their management, irrespective of whether the concern was working at a profit or making losses

By the Indian Companies (Amendment) Act of 1936, the defects of the Managing Agency system were, to a great extent, removed The Amendment Act fixed the term of office of the Managing Agent to a period of 20 years The Act further provided for the removal of the Managing Agent in certain circumstances, even if there was an agreement between him and the company fixing his term of office for twenty years, as when he had committed a non-bailable offence under the Indian Penal Code or where the Managing Agency was a firm or a company, an offence was committed by a member of such firm or the company unless the offending member of the firm was expelled within thirty days of the conviction for such offence or his conviction was set aside Under the Act, a Managing Agent vacated his office the moment he was adjudged an insolvent, or, if he transferred his office and such transfer was approved by the company in the general meeting The Act laid down that the remuneration of the Managing Agent shall be a sum based on a fixed percentage of the net annual profits of the company with provision for a minimum payment in the case of absence or inadequacy of profits together with an office allowance to be defined in the agreement of Managing Agency Any stipulation for an additional remuneration in any form was not binding on the company unless such was sanctioned by the general meeting Further, a charge or assignment of the remuneration of the Managing Agent was void as against the Company However, the managing agent was entitled to his remuneration and dues, if any, on the termination of his office, either voluntarily or com-

pulsorily Under the Act, the company was prohibited from making a loan or guaranteeing it to the Managing Agent or to a partner of the Managing Agency, if a firm. Nor could a Managing Agent enter into any contract of sale or purchase with the company unless three-fourths of the directors voted for it Further, the Act provided that no Company under the Management of a Managing Agent shall make any loan to or guarantee any loan made to any company under the management by the same managing agent, and no Company shall, after the expiry of six months from the commencement of the said Act except by way of renewal of an existing loan or guarantee given, make any loan to or guarantee any loan made to any such company. However, the above conditions did not apply to loans made or guarantees given by a company to or on behalf of a company under its own management or loans made by or to a company to or by a subsidiary company thereof or to guarantee given by a company on behalf of a subsidiary company thereof Further, the Act prohibited companies, from purchasing shares or debentures of any company under management by the same Managing Agent, unless such purchase was previously approved by a unanimous decision of the Board of Directors of the purchasing company These conditions did not of course apply where the purchasing company was an investment company The Act also imposed restrictions on the Managing Agents' power to issue debentures and in the matter of the investment of the funds of the company A Managing Agent can issue debentures and invest the funds of the company only within the limit set under the authority of directors and any delegation of such a power is declared void under the Act The Act also prohibited a Managing Agent from engaging in business competing with the business of the managed company. Further, the number of directors which the Managing Agent could appoint was limited to a third of the directorate under the Act.

With these amendments, it is hoped that the Managing Agency system would continue to play its useful part in the industrial development of India without being accompanied by any of its disadvantages

Commercial Banks and Industry:

The question as to the role that Commercial Banks should play in the financing of industries came up before the Central Banking Enquiry Committee Witnesses complained that Commercial Banks were not granting adequate finance facilities and, even when they granted, they kept

a margin to the extent of at least 30 per cent They were not willing to renew when the industries needed it The Committee recommended that the Banks should grant adequate advances and for deciding the advance amounts they should appoint experts to value plant and machinery for the purpose of granting such advances

It is true that Commercial Banks do not make long-term advances as they are required to maintain their funds in a liquid form and they cannot, therefore, afford to lock up their funds for longer periods But many of them do make short-term advances to industries The representative of the Imperial Bank and some witnesses from Banks testified before the Committee that industries found no difficulty in getting advances from Banks, if they offered proper security The Commercial Banks advance mostly on stocks of goods They advance even on raw materials. In advancing funds to industrial concerns, a Commercial Bank has not only to see to the soundness of a particular firm but also to the general character and prosperity of the industry In fact, Commercial Banks, if they have have proper equipment, are the best judges regarding the prospects of a particular industry, and the nature of its financial requirements can be best seen by them Hence, while making advances, they do so with care

It is true that they are not able to finance fixed capital by means of taking debentures, nor are they able to afford long-term working capital It is said that, though the resources of Commercial Banks are small, they can utilise their resources for the purchase of debentures of industrial concerns with a view to passing them on to the public with very little risk to themselves and with great advantage to industries But the success of these operations largely depends upon the existence of an organised capital market and ready investors who would purchase the debentures offered by the Commercial Banks If there is any delay in the disposal of the debentures taken by the Commercial Banks, then they would place themselves in a precarious position Though the Commercial Banks do not advance funds or long-term working capital, they do finance certain stages of production The advances which the entrepreneurs get for meeting their expenses in the earlier stages of production enables them to produce further Still the role of the Commercial Banks is not adequate Accordingly the Central Banking Enquiry Committee recommended the establishment of an Industrial

Corporation on an all-India basis and Provincial Industrial Corporations

Industrial Corporations, as envisaged by the Central Banking Enquiry Committee, are to be institutions investing in shares and debentures of industrial concerns and in long-term loans of such, and are themselves financed by share and debenture capital The proposed corporation should derive its capital partly by share capital and partly by debentures They should obtain the capital as far as possible from the public, the Government taking such portion of the capital as cannot be raised by public subscription The Share capital should be supplemented by means of debentures not exceeding, at the outset, twice the amount of share capital The Government should also take a portion of the debenture capital issued by such Industrial Corporations until a market has been created for that purpose and also guarantee interest on them The corporations may also receive deposits from the public for a period of not less than two years and the period of loans should be adjusted to the period of deposits The Government should have powers to appoint Directors so long as it subscribed either for shares or for debentures or guaranteed interest either on share or on debenture capital The corporations should specialise in long-term finance to industries, while, for the working capital, industrial concerns should continue to depend upon the existing institutions The grant of assistance to industrial concerns should depend upon the extent to which the enterprise in question is of benefit to the public, add the productive power of the Province, as also the ability to provide employment

Role of State in relation to Industrial Finance

As already observed, following the recommendations of the Industrial Commission (1918), many Provinces like Madras, Bombay, Bihar, Orissa, and United Provinces passed State Aid to Industries Acts[1] Even Indian States like Mysore, Hyderabad, Gwalior and Baroda passed similar legislation

Under the Act, the Provincial Government was empowered to give aid to nascent industries, or to industries started in places where no industry existed before, and to cottage industries The aid generally took the form of

(1) The Bihar and Orissa State Aid to Industries Act (1923)
The Madras State Aid to Industries Act (1922)
The Bengal State Aid to Industries Act (1931)

"the grant of a loan, the guarantee of a cash credit overdraft or fixed advance with a bank, guarantee of a minimum return on the whole or part of the capital of a joint-stock company for a fixed period. grant on favourable terms of land, raw-material, firewood, water or any other property of the local Government, grant, free of charge or on favourable terms, of the services of experts or Government officials, payment of subsidy for the conduct of research or the purchase of machinery."[1] The amount sanctioned to individuals and private firms varied according to industries. Each Province framed its own rules for procedure to be followed for obtaining aid under the Act.

Working of the State Aid to Industries Acts:

The results of the working of these Acts do not reveal that any substantial benefit has been derived either by industrial concerns or by the State, the latter being unable even to recover the funds advanced In some Provinces where the State Aid to Industries Act was in force, the loans made under the Act could not be recovered due to the failure of business of the firm or the individual to whom the loan had been granted In some Provinces, Government made advances to concerns known to be not deserving the support, with the consequence that the Government had to write off the losses The failure of the Acts was further due to the absence of a suitable and efficient machinery to disburse public funds after careful investigation The State Aid to Industries Act failed, in short, to realise the object, and the only result was that taxpayers' funds were frittered away by the Provincial Governments.

The results of the working of these Acts in Indian States, however, appear to have yielded relatively better results This is particularly true of Mysore, where the State Aid to Industries Act began as early as in 1913 Even as far back as in the year 1930-31, the State Government, which advanced 14 35 lakhs, was able to recover Rs 9 64 lakhs and only Rs 50,000 had to be written off[2]

Present position of Industries:

The industries in India have developed in recent years to a very great extent and, therefore, the prospects are not very gloomy Between the period of two World Wars

(1) S K. Basu, *Industrial Finance in India*, page 220

(2) Report of the Administration of the Department of Industries and Commerce, Mysore (1930-31), page 4

(1914-18 and 1938-45), the development of industries in India was remarkable as can be seen from the following table relating to but four industries:

Name of Industry	Year 1914-15		Year 1938-39	
	Number	Capital in lakhs	Number	Capital in lakhs
		Rs.		Rs.
Cotton Mills	205	16,70	376	33,04
Jute Mills	34	7,61	82	20,47
Tea	208	4,31	423	12,71
Sugar	22	80	157	10,98

The industrial concerns can mobilise the required capital provided the concerns are sound and the people have confidence in the management While it is true that, till recently, there were no Issue Houses in India on the model of those existing in the United States or Great Britain to underwrite shares of industrial concerns, nevertheless, in recent years, their place has been taken by Investment Corporations, private financiers, and stock and share brokers.

In recent years, a large number of concerns has been floated by businessmen in India, taking advantage of the easy money conditions The Government has also taken up an encouraging attitude and permitted the floatation of a number of companies in spite of the Control over Capital Issues.[1] The Government has further set up a Tariff Board to consider the question of protection of national industries, and have granted special facilities for the import of capital machinery These factors have ushered in a new era of industrial prosperity

Even so the question of finance to industries has received the attention of the Commercial Bodies and the Government of India Proposals were put forward by the Government for the establishment of an Industrial Finance Corporation in 1946 These proposals were embodied in a bill which was introduced in the Central Legislative Assembly was referred to the Select Committee in 1947. The Industrial Finance Corporation Bill as amended by the Select Committee was passed in February (1948) in the Constituent Assembly (Legislative)

(1) Consent for the issue of capital was given to 3,784 companies involving a total capital of Rs 260 5 crores, of which the industrial issues numbered 1,766 involving an amount of Rs 150 6 crores at the end of the year 1945-46. (Report on Currency and Finance for the year 1945-46, page 88)

The New Industrial Finance Corporation (1948):

The Industrial Finance Corporation will be a State-aided institution having an authorised capital of Rs 10 crores, and its jurisdiction extends to the whole of India including such Indian States as have acceded to the Indian Union For the present the issued and paid up capital of the Corporation will be Rs 5 crores divided into 20,000 Shares of Rs 5,000 each, fully paid up. Of these the Government of India and the Reserve Bank will take up shares of the value of Rs. 1 crore each, and 1,000 shares have been offered to the co-operative banks, and the balance is offered to scheduled banks, insurance companies, investment trusts and other like financial institutions The balance of the share capital of Rs 5 crores is to be issued from time to time, with the sanction of the Central Government to the same group of allottees in the same manner and proportion as in the case of the first issue The Government will guarantee dividend on shares at rates to be decided by them at the time of issuing the shares

The general superintendence and direction of the affairs of the Corporation has been entrusted to a Board of 12 Directors of whom 6 will be nominated by the Central Government and the Reserve Bank including the Managing Director and other 6 will be elected from among the institutional shareholders of the Corporation

The Corporation will establish offices at Bombay, Calcutta, Delhi, Madras and Cawnpore Offices may be established in other places with the sanction of the Central Government The Corporation is authorised to supplement its share capital by the issue and sale of bonds and debentures not exceeding five times the amount of the share capital and the reserve fund The principal and interest in respect of bonds and debentures will be guaranteed by the Government, the latter at a rate to be determined at the time of issuing bonds and debentures Further the Corporation is authorised to accept deposits for periods of not less than five years provided the total deposits do not exceed twice the amount of the paid-up capital and the reserve fund

The Corporation is authorised to grant secured loans to public limited industrial concerns and co-operative societies engaged in industries repayable within a maximum period of 25 years It may guarantee loans raised in the market by industrial concerns for an agreed rate of commission It can underwrite the issue of stock bonds and debentures and can retain as part of its assets such stocks,

bonds or debentures as it may have to take up in fulfilment of its underwriting obligations, but it is required to dispose of any such stock bonds or debentures within a period of seven years Further the maximum amount of accommodation it can grant to any single borrower by way of loan, undertaking or underwriting agreement is limited in the aggregate to an amount of Rs. 50 lakhs In cases where industrial concerns require loans in foreign currency, the Corporation is authorised with the previous sanction of the Central Government to borrow such funds through the International Bank for Reconstruction and Development or otherwise

Further, it has been provided that the Corporation might set up Advisory Committees to offer advice on technical matters in regard to a particular industrial concern applying for a loan

The Corporation has wide powers to satisfy itself before granting financial accommodation to an industrial concern even to the extent of appointing its nominee on the Board of Directors of the borrowing Company The Corporation is also authorised to take over an industrial concern on a breach of agreement by the particular company concerned

The Corporation will be under an obligation to pay income tax and super tax like any other private business corporation

In establishing an Industrial Finance Corporation India is following the example of the other industrialised countries of the world In Japan as early as in 1902 an Industrial Bank was established, to afford financial aid to Industries In Finland an Industrial Mortgage Bank was created in 1924 with capital supplied mostly by joint-stock banks to meet the long term requirements of industry The National Hungarian Industrial Mortgage Institute was created in 1928 for granting amortisation loans to industry Eighty per cent. of the capital for the above institute was supplied by the Treasury, the balance being supplied by the National Union of Manufacturers In Poland the Economic Bank was brought into existence in 1926 which was empowered among other things to grant industrial loans Even in a highly industrialised country like the United States, where there are issue houses and investment houses and good capital market, the need to have a special institution was emphasised, particularly after the depression (1929-33), and the Reconstruction Finance Corporation was

created only with the object of helping industry and agriculture Great Britain established only recently in 1945 two institutions, viz, the Finance Corporation for Industry, Ltd, and the Industrial and Commercial Finance Corporation, Ltd. The purpose of the former is to provide finance for industrial business concerns with a view to their quick rehabilitation in the national interests, and that of the latter is to supply medium and long term capital to small and medium sized industries The Canadian Industrial Development Bank, Ltd, was created as a subsidiary to the Bank of Canada to ensure adequate credit to sound Industrial enterprises In Australia a separate Industrial Finance department was created in the Commonwealth Bank to assist the establishment and development of industrial undertaking

It is therefore in the fitness of things that India should have decided to establish a Corporation of its nature, though late, to help the large scale industry started by private enterprise However, it must be noted that it is not the business of the Corporation to supply all the necessary capital for the establishment of an Industrial concern which the particular Industrial concern in question is required to obtain from normal sources and from the open market But there are occasions when an industrial concern already established finds it difficult to raise an additional capital in the open market for meeting capital expenditure It is at such a critical time that the Corporation of this type is expected to come to the rescue of the industrial concern [1]

However, the establishment of such a State-aided Corporation will have certain implications It is evident that the Corporation competes in the market for the national savings by means of deposits As the deposits are fairly of a long-term character, the investment will be restricted again to business firms and industrial firms, for the small savers would hardly wish to invest in long-term deposits The funds invested as long-term deposits in Commercial Banks by insurance and other business concerns would be diverted from these banks and flow to the Corporation, thus reducing the capacity of banks to make short-term advances to such smaller industrial establishments as cannot approach the Corporation They have, therefore, to suffer from want of finance even with an Industrial Fin-

(1) Vide the statement of Mr R K Shanmukham Chetty, the Finance Minister in the Constituent Assembly (Legislative) on 30-11-1947.

ance Corporation in existence Secondly, there are a large number of industrial concerns not based on joint-stock principle Such concerns also require financial help It will, therefore, be necessary to organize private investment trusts and industrial banks

II

Financial Needs of Cottage Industries:

Rural or cottage industries are those the production of which is not based on large-scale or mass methods of production Cottage industries are known to the people of India from very early times, and they have continued to play their part even during the present times, though a large number of them have declined, or are in the declining stages The Central Banking Enquiry Committee has enumerated certain industries like hand-loom, weaving, pottery, rope making, sericulture, gold and silver thread, brass-ware, bell-metal, mat-making, gur-making, dairy-farming and the work of village artisans generally as cottage industries Incidentally these industries afford useful and lucrative occupation to agriculturists in their spare time

There are many problems affecting these industries which require serious study We shall, however, confine ourselves here mainly to their financial requirements The financial needs of these industries may be summed up under three heads (1) Purchase of raw-materials, (2) working expenses during the period of production, and (3) financial accommodation between the period of production and final disposal of the products

The various financial agencies at present engaged are the urban and the rural money-lenders, the merchants or dealers in raw materials or produce of an industry, co-operative banks, producers' societies, joint-stock banks, and the co-operative departments of the Provincial Governments

It is well-known that the money-lender as a credit agency has his own price for lending money, with the consequence that the artisan has to incur a high cost in producing his goods The role of commercial banks is inadequate It is, therefore, suggested that the co-operative movement alone can afford the requisite facilities In fact, the Central Banking Enquiry Committee has recommended the establishment of co-operative institutions to afford financial facilities to cottage industries The Foreign experts, the Provincial Committees and even the Minority Re-

port are unanimous on this point However, there are certain defects which must be removed as far as possible. In the first place, the co-operative movement must tackle the problem of credit. There should be co-operative purchase and sale societies, and the credit societies should work separately from the purchase and sale societies. Secondly, the Government should take greater interest by taking greater financial interest and by establishing emporiums The State should assist these industries by having better co-ordination between the co-operative and the industries departments

Success of applying co-operative principles to cottage industries:

If the industries based on cottage industries principle are the same which are also produced under capitalistic methods of production then the products of the latter are sure to compete effectively with the products of the former resulting in the destruction of the former. In that case even the application of co-operative principle would not support cottage industries It will be, therefore, necessary to organise such industries on cottage industry basis which form non-competing group from the machine based industries

CHAPTER VIII

FINANCING FOREIGN TRADE

EXCHANGE BANKS

An Exchange Bank has as its main business the financing of foreign trade by enabling the exporter to get payment for merchandise shipped to foreign countries, and the importer to make payments for the purchases he would make in foreign countries An Exchange Bank does this function of procuring foreign currency for making purchases abroad, and by converting the moneys paid in foreign currencies in foreign countries due to national exporters on account of their exports For this purpose it deals in foreign currencies * In view of the fact that the foreign trade of a country constitutes a factor vitally affecting its national economy, almost all countries have their own exchange banks for financing their foreign trade For obvious reasons, unfortunately, India has so far not had any national exchange bank

There are at present a large number of foreign Exchange Banks operating in India engaged in this business, which mainly consists in dealing in foreign bills of exchange and remittances Of the many, two are of no main concern as they deal mostly with tourist trading

The following are the foreign Exchange Banks operating in India —

(1) Chartered Bank of India, Australia and China.
(2) Eastern Bank, Ltd
(3) Hong-Kong & Shanghai Banking Corporation
(4) Mercantile Bank of India, Ltd
(5) Grindlay & Co, Ltd
(6) National Bank of India, Ltd
(7) Bank of China, Ltd
(8) Netherlands India Commercial Bank, Ltd
(9) Tomas Cook (Bankers)

* The following are the sources of foreign exchanges —
(1) Favourable balance of payments, resulting from exports of greater value than imports
(2) Capital movements
(3) Interest payments
(4) Loan transactions
(5) Exports of precious metals

(10) National City Bank of N.Y.
(11) Bank of Communications, Ltd.
(12) Netherlands Trading Society
(13) American Express Inc
(14) Banco National Ultramarino
(15) Lloyds Bank, Ltd.
(16) Comptoir National D'Escompte of Paris.
(17) Yokohama Specie Bank, Ltd (suspended during the war time)

The finance of foreign trade consists of two operations, viz, (1) financing from the Indian Port to the Foreign Port or **vice-versa,** and (2) the financing from, or to, the Indian Port, to, or from, the upcountry distributing or collecting centre

Although it is true that there was no legal bar which prevented the Indian banks from engaging in this business, the practical difficulties in the way were responsible for Indians not taking to this business The fact was that the Indian banks had to face the competition of the already established foreign banks, particularly because Indian banks have had, until recently, no branches in London and other important centres which precluded them from taking part in arbitrage and direct exchange transactions However, a bank which was capable of competing with the Exchange Banks effectively—the Imperial Bank of India —was prevented and prohibited from taking part till recent years (1934) The resources of the Indian banks were small till recently, as compared with the volume of business, and the same resources could be employed in internal business in a profitable way—a factor which dissuaded the Indian banks from taking to financing foreign trade

While the above factors have prevented the Indian banks from taking to this business so far, there are even to-day factors which are still in the way of Indians An Indian institution requires a big amount of capital to open its office in London Such an office must be maintained for sometime even if it entails a loss There are then the difficulties of procuring the necessary staff and of large floating resources

In recent years, in addition to financing foreign trade from the Indian port to the foreign port and **vice-versa,** the foreign exchange banks are also taking part in financing the movement of goods from the interior to the port town and **vice-versa.**

For example, in the case of goods imported into Delhi, the inward bill drawn by the foreign exporter is sent to the branch of the foreign Exchange Bank in Delhi and is collected in due course from the importer there and the proceeds remitted abroad Similarly, in the case of exports from, say, Amritsar, the Indian exporter can draw a bill on the foreign buyer under the letter of credit opened by the buyer and sell it direct to the branch of the Exchange Bank at Amritsar The Exchange Bank branch would send the bill to its Head Office where it would be retired or collected from either the foreign importer or discounted in the London Money Market Enquiries made by the Central Banking Enquiry Committee revealed that Indian exporters and importers preferred the financing to be arranged by a single agency as this arrangement was cheaper to them It was only when there was no branch of the Exchange Bank that the financing of the internal trade upto port town and vice-versa was done by Indian joint-stock banks, the Imperial Bank, the indigenous bankers, and the commission agents

Mechanism of finance—exports and imports:

Taking the financing of trade from a port town to a foreign port, one finds that, when an exporter sells to a foreign buyer, say to the United Kingdom, credits are usually opened with the London Banks or Finance Houses and the party in India advised through the medium of their branches (Exchange Banks) The bills against such credits are drawn at 90 days' sight, and they are chiefly documentary The bills may be Documents on Acceptance or Documents on Payments The rate for 90 days' bills is higher than those for demand bills to allow for interest during the usuance of the bill, this rate being regulated by the rate of interest ruling at the centre on which the bill is drawn These bills are sent to London for acceptance, and, after endorsement by the Exchange Banks in London, they are usually discounted in the London Money Market

The bills may further be taken to the Bank of England for rediscount, in which case it should have two British Signatures In this way, the Exchange Banks receive back in sterling the equivalent of their rupee payments in India Some of the banks having sufficient funds at their disposal may hold the bills till maturity when the importer or his bank will pay But, if the money conditions are tight, then the Exchange Banks discount their bills in the money market If the bills are sent for collection by the Indian

exporter through an Exchange Bank, then the Indian exporter has to wait for the maturity of the bill before he gets his value in rupees Generally, the Exchange Banks allow the Indian exporters to draw funds immediately, but, if the foreign importer does not pay before maturity, then the Indian exporter will be required to pay what he has received from the exchange bank Only where the foreign importer has not opened an irrevocable letter of credit, this procedure of sending the bills for collection is usually followed But this is not common

The import trade is financed in two ways (1) Firstly, by 60 days' sight D P drafts drawn on the importer Under this system, the foreign exporters draw 60 days' Documents on Payment bills on Indian importers and discount with a London Bank having its branch in India These bills, along with "letters of request and hypothecation" in favour of the Exchange Banks, are forwarded to the branch of the Exchange Bank doing business in India These Banks send the bills to the Indian importer for acceptance Immediately on acceptance, the Indian importer has 60 days' time for making the payment and receiving the documents But if the importer wants the bills to entitle him to receive the goods immediately, on acceptance of the bills he will forthwith execute a trust receipt under which he receives the goods before payment This procedure is followed by Indian importers and those British importers in India who give no bank references (2) Secondly, a totally different method is followed by some In certain cases where imports are made by European firms, the method of 'House Paper' is used In this case, the exporting firms in London draw bills on the London Money Market The Bank which has accepted the bills will send the same to its office in India and this Indian Office will collect the funds from the Indian Office of the exporting firm and will remit the money to its head office In other words, firms having their offices in India will get goods on credit for two months before which they will have to pay for the bills In this case, instead of the London bank paying, it is the money market (discount market) that pays the exporter immediately, the London Bank, through its India office, collecting the proceeds later from the Indian branch of the London exporting firm and paying the discount on the maturity of the bill, or when presented by the discounting firm

The bills in both the cases are drawn in Sterling and in the former case interest is charged from the date of the

bill to the approximate date of arrival of the proceeds of the bill in London at a rate higher than the Bank of England rate and in the latter case the paper is discounted at the prevailing discount rate which is invariably lower than the rate of interest charged on 60 days' D P drafts Therefore European importers having London Offices of standing to arrange for acceptances of their paper stand to benefit over their Indian competitors Even in the former case the European importers are at an advantage because of the cheaper rates of interest prevailing in London Money Market and the bills are drawn in sterling

The opinion of the foreign experts associated with the Central Banking Enquiry Committee that as interest rates are cheaper in London Market than in India, the alleged advantage obtained by drawing in rupee bills would be nullified by the increased cost of imported goods was not accepted by the Committee on the ground that the rate of interest payable by the Indian importer was not based on the rates prevailing in the London Money Market and that therefore the natural bill market was in India and not outside

The bulk of the bills between India and Europe, America and the colonies are drawn in sterling The drafts from and to Japan are in terms of Yen, while with China they are in terms of rupees

From the above it is clear that an Exchange Bank having its branch office in India and its Head Office in London will be having its rupee resources in Indian branch and sterling resources in its London Office The rupee resources in India will be utilised for making payments to those who present their export bills against credits opened in their favour in its London Office The sterling resources will be utilised for making payments to exporters in London on behalf of the Indian importers who would have deposited (paid) or have agreed to deposit (pay) in rupees in their Indian Office at a certain rate of exchange When an Exchange Bank branch in India accepts the exporters' bills and pays to the Indian exporters its rupee resources in India will be reduced while there will be a corresponding addition to its sterling resources in London When an Exchange Bank is presented with export bills of greater amount than the amount of import bills presented to it, its rupee resources get depleted unduly and its sterling resources in London increase In such cases the particular exchange bank will be required to attract rupee

deposits in India, or purchase rupees from the Reserve Bank in exchange for sterling to be delivered in London. Similarly with an increase of import bills presented to it consequent on increased imports to India, the rupee resources of an exchange bank would increase while the sterling resources in London would be depleted In such a case it will be required to increase its sterling resources in London However, India has generally a favourable balance of trade When the export bills are greater than import bills and a sterling surplus is left in London, exchange banks get the corresponding rupee finance for these sterling amounts either by importing gold or silver bullion or by selling sterling payable in London to the Reserve Bank. The statutory obligation imposed on the Reserve Bank of India to buy and sell sterling in amounts of not less than £ 10,000 enables the Exchange Banks to met demands for payment in rupees to Indian exporters and sterling demands to foreign importers

In addition to financing the foreign trade as detailed above, the foreign Exchange Banks have been taking part in financing internal trade, particularly the movement of goods from the collection and distribution centres to Port towns and **vice-versa** They have been able to do so by opening branches in the interior places and, sometimes, by acquiring controlling interest in the Indian joint-stock banks The P. & O Company, soon after its floatation, purchased the Allahabad Bank which had as many as 40 branches and sub agencies all over India Lord Inchcape, commenting upon this acquisition, said, "our acquisition of the Allahabad Bank gives us a footing in the interior of India which it would have taken years to work up" The controlling interest in the P & O. Banking Corporation itself was acquired in 1927 by the Chartered Bank of India, Australia and China which purchased 1,96,059 shares out of 2,59,416 shares [1]

The dominant position they have come to occupy has enabled the Exchange Banks to finance internal trade in addition to foreign trade and correspondingly to deprive the Indian banks of their business The fact that Indian businessmen, exporters or importers, in the interior places prefer a single agency for financing from the interior to the foreign port and **vice-versa** has further encouraged and strengthened their position Indian business men prefer-

(1) Report of the Central Banking Enquiry Committee (1931), Vol. 1, page 333

ied Exchange Banks, because no other consideration was more valuable to them than cheapness The consequence has been that the share of the Indian banks is restricted to financing internal trade in those places where the Exchange Banks have no branches, while, in regard to the financing of foreign trade, the share of the Indian banks is nil

The great part that the Exchange Banks play in the internal trade will be clear when it is seen that they devote as much as 1/6th of their total deposits to financing foreign trade, while a substantial portion of the rest is utilised for internal trade [1]

Thus, much of the piecegoods trade in Delhi and Amritsar, the leather trade in Cawnpore and the jute trade in Bengal is financed by the Exchange Banks In addition, they also import gold and silver bullion to the account of their Indian clients Within seven days after the receipt of bullion, the clients or buyers will have to make payments and receive the gold or silver stocks They also finance the Marwari bankers by discounting the latter's bills

The enormous business enpoyed by the Exchange Banks in India has greatly contributed to their growth, and the following figures are illustrative of their important position —

DEPOSITS OF EXCHANGE BANKS IN INDIA

Year	Amount (in crores)
	Rs
1870	52
1880	3 39
1890	7 54
1900	10 50
1910	24 70
1920	74 80
1930	68 11
1940	85 32
1941	106 73
1942	116 85
1943	140 19

The predominant position of the Exchange Banks and its consequences on the Indian trade and commerce were alluded to by the witnesses before the Central Banking Enquiry Committee Primarily, these banks were not sub-

(1) S G Panandikar, *Banking in India*, page 203

ject to any law like the Indian banks The Directors, the shareholders and the executives of these banks are all foreign The result has been that the Indian depositors have had no protection, nor could Indian business men influence the policies of the banks Further, these banks were active competitors of the Indian banks in the matter of receiving deposits

What Indian public opinion felt most was that the monopoly should have been carried on with Indian money to India's disadvantage The share of Indians in the financing of foreign trade was only 15 per cent [1] In addition, the Indian shipping and insurance companies were practically out of the picture in this business, as the Exchange Banks insisted on or preferred foreign companies, for obvious reasons An authoritative estimate has placed the loss to the Indian insurance companies on this account between two and three crores of rupees annually [2] However, the Central Banking Enquiry Committee opined that, with mutual goodwill on either side, the Exchange Banks might be persuaded to accept the policies of Indian insurance companies This hope has not been realised to the extent expected That the Exchange Banks have failed further in their obligation to give good references to Indian business men was another complaint made by the witnesses before the Central Banking Enquiry Committee The representatives of foreign banks operating in India denied the allegation and said that, where Indian business men did not disclose their accounts, it was inevitable that they should do so. It must be said, in fairness to these foreign banks that they have given good references about their clients having a clear long standing business connection with them

The present arrangement of drawing bills, both import and export, in sterling has discouraged the development of a bill market in India, the creation of which would undoubtedly benefit the Indian importer Further, this system has given a decided advantage to foreigners, either exporters or importers, in that they have the benefit of the London Money Market While the terms for Indian importers are D P, bills for foreign importers are D A Indian importers can also obtain delivery of their goods immediately on acceptance, but, in this case, they have to

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 322

(2) Ibid, page 326

pass a trust receipt under which a criminal liability is attached Thus, when an Indian importer wants the Exchange Banks to open a letter of credit for him, these banks demand 15 to 25 per cent advance on the alleged ground that Indian business men have inadequate resources to meet their obligations and their dealings are invariably of doubtful honesty This has been the source of not a bitter resentment to Indian business men, which explains the insistent demand for restricting the activities of Exchange Banks

Suggestions for restricting the activities of foreign Exchange Banks:

Now the proposals for restricting the activities of foreign Exchange Banks mainly centre round two points, viz, the licensing of foreign institutions, and, the imposing of restrictions on their business activities, such as receiving deposits, etc

It was suggested that foreign banks operating in this country should be licensed as has been the practice followed in other countries in regard to foreign banks operating there The Central Banking Enquiry Committee approved the proposal with these words "The introduction of a similar system is, in our opinion, necessary, partly in the interest of depositors, partly for ensuring the grant of reciprocal treatment in foreign countries to Indian banks, and partly for giving the Reserve Bank some control over the banks operating in the country [1] It may be noted here that the Banking Bill (1945) provided for the licensing of foreign banks

The suggestion for restricting the scope of Exchange Banks in receiving deposits was put forward by some witnesses before the Central Banking Enquiry Committee These suggestions were not viewed with favour either by the representative of the Imperial Bank or the Foreign Experts associated with the Committee Even the Central Banking Enquiry Committee disapproved of the proposal and remarked "The compulsory diversion of deposits even partially may result in the same deposits coming back to the Exchange Banks through the Indian banks at increased cost for use in exchange operations and the additional cost would be passed on to the Indian trader and ultimately the Indian producer so long as margins are kept

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 329

at the narrowest limits by competition as at present"[1] It was also suggested before the Committee that the Exchange Banks should be restricted in the matter of opening their branches.* Even this proposal did not find favour with the Central Committee.

The imposition of restrictions on the activities of foreign Exchange Banks is hardly likely to promote international co-operation so necessary for the economic well-being of the world It is also likely that such a thing might lead to a retaliation If India wants to introduce measures restricting the operations of foreign banks within her territories, it is very likely that other countries will imitate India in the matter of restrictions on the operations of foreign banks within their territories, which is likely to have adverse effects on Indian Banks yet to take to foreign exchange business

The case for an Indian Exchange Bank:

The lack of proper facilities for Indians to take a greater part in handling the business of financing foreign trade has given rise to the question of creating an Indian Exchange Bank for this purpose Looking to the heavy cost involved, the Central Banking Enquiry Committee and the Foreign Experts associated with the Committee suggested that well-established Indian banks could open foreign connections for the benefit of their customers as the German banks did to avoid the heavy cost of establishing branches in foreign countries Agreeing with the Foreign Experts associated with it, it suggested that, after the establishment of the Reserve Bank of India, the Imperial Bank might be encouraged to play an important role in the financing of foreign trade by removing the restrictions imposed on it by the Act of 1920 regarding foreign exchange business These restrictions had been imposed as the Imperial Bank was a banker to the Government and as such it was felt it could not hazard foreign exchange business involving risk and uncertainty The position which the Imperial Bank had built up in the banking system was sufficient to entrust it with this business and the Managing Governor of the Imperial Bank, in his evidence before

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1, page 336

* Number of offices of Exchange Banks

Year	No	Year	No
1938	93	1941	99
1939	99	1942	84
1940	101	1943	84

the Central Banking Enquiry Committee, admitted that the Bank could easily establish connections with the London money market so necessary for this purpose. The agency business which it did for some of the Exchange Banks, the large amount of its inland trade finance, and the extensive area of its working would help the Bank to make a success of foreign exchange business

The Committee also recommended, in the event of the above proposals falling through, the establishment of an Indian Exchange Bank with a capital of Rs three crores The capital of the proposed bank should be obtained in the course of three years to be subscribed mostly by the Indian joint-stock banks If the capital was not forthcoming, the State should subscribe and, in the course of years, should sell off its holding to the public As long as Government held shares, it should have the right to nominate its representatives The help of the Reserve Bank should also be taken for rediscounts of foreign bills, as the resources of the newly created Exchange Bank would not be adequate in the initial stages of its establishment The Government should also encourage the Bank by appointing it as the agent of the Reserve Bank for making foreign remittances on behalf of the Government

The Central Banking Enquiry Committee had also before it another proposal for the creation of a scheme of "Joint-Banks" to be worked by Indians and foreigners on a profit-sharing basis The Committee was inclined to favour the proposal with these words "The idea of Joint-Banks in the sphere of international trade, which postulates co-operation and good-will among nations with each other is valuable one" However, the Committee observed that at that time conditions were not quite favourable for working out such a scheme

In the event, no Exchange Bank has been established as yet In the existing circumstances, international co-operation should be the basis of trade among countries of the world and a policy of isolation hardly promotes good The only solution of the problem as suggested by the Committee in 1929 is, therefore, that "Indian joint-stock Banks and foreign banks should endeavour to find out some method of affiliation or amalgamation which would result in co-operation and would, at the same time, avoid undesirable criticism that either party was aiming at confiscation, absorption, or domination"[1]

(1) Report of the Central Banking Enquiry Committee (1931), Vol 1 page 353

CHAPTER IX

IMPERIAL BANK OF INDIA

The history of the Imperial Bank of India falls into three stages The first stage covers the period from the establishment of the Presidency Banks upto their amalgamation, the second period is from 1921 to 1934 and the third period dates from 1934 onwards

The aim of having a Central Bank was mooted from time to time as it was so necessary to unify the currency and credit systems of the country Attempts made earlier to bring about the amalgamation of the Presidency Banks failed partly, due to the indifference of the Government and partly, because of mutual jealousies among the Presidency Banks themselves

The Presidency Banks had the right of note issue till 1862 and they acted as Bankers to their respective Presidency Governments In 1862 the Government deprived them of their right of note issue. However, they continued to act as agents to manage the notes issued by the Government At the same time they were given the use of Government balances free of charge The Act of 1876 imposed further restrictions on them in that they were particularly prohibited from transacting the business of foreign exchange and from borrowing or receiving deposits payable out of India Nor were they permitted to lend for a period longer than six months whether on the security of immovable property, or on promissory notes with less than two signatures, or upon goods without the deposit of either goods or the documents of title thereto At the same time the Government divested themselves of all their responsibilities by withdrawing their share capital and by ceasing to appoint directors Even the Government balances with them were reduced to a minimum The Banks continued as independent entities till 1921 when they were amalgamated into the present Imperial Bank of India.

The new Bank—The Imperial Bank of India—had a total paid up capital of Rs 5 62 crores and reserves of about 4 02 crores on the date of the amalgamation (1921) and the Government once again began to evince interest in it.

The management of the Bank was vested in a Board of Directors consisting of 16 Directors, who were then

known as Governors Of the 16, as many as 10 Governors were appointed by the Governor-General Those appointed by the Governor-General were two Managing Governors, four non-official Governors representing the Indian interests in general, three Secretaries of the local Boards, and an Officer of the Government of India—usually the Controller of Currency The remaining six Governors were elected, two each from among the shareholders of the local Boards They were the President and the Vice-presidents of the local Boards

In the absence of a Central Bank to unify currency and credit and to serve as a banker to the Government, the Imperial Bank occupied a unique place in the Banking system of the country It served as a banker to the Government and to some extent, was treated as a bankers' bank, in that it managed the clearing houses in important towns of India and offered remittance facilities

The Imperial Bank was given the management of the public debt, the general banking business of the Government and the holding of treasury balance without interest In return, the Bank was asked to open 100 new branches within five years, of which the location of the offices of as many as 25 was to be decided by the Government By the year 1926 (Dec) the Bank had as many as 186 branches, including "the 102 new branches which it opened by March, 1926 under Government directions, out of which 36 were located in places where there was no bank previously and 89 were located in places where there were treasuries"[1] and in these places the treasuries' balances were transferred to the Bank and the treasuries closed The Bank was asked to give remittance facilities through its branches to the public at rates determined by the Controller of Currency Certain restrictions were also imposed on the lending power of the Bank in that it was not permitted to lend on a negotiable security of more than six months' duration Nor was the Bank permitted to deal in foreign exchange except that it be to the bonafide personal requirements of its clients Further, the Bank was not permitted to open new accounts in its London office to its clients who were not its clients (Presidency Banks) for three years previously

The Bank acted as a Bankers' Bank and many Banks, including the Exchange Banks, kept deposits with it It offered remittance facilities and managed clearing houses

(1) Dr S K Muranjan, *Modern Banking in India*, page 104

The functions which the Bank was authorised to do under the Act of 1920 can be conveniently classified under the headings advances, borrowing powers, dealings in bills of exchange, ordinary banking business, and other business

Advances:

The Bank was permitted to do the following.—

(1) Advance money and opening cash credits on the security of

(a) Stocks, Funds and Securities in which a trustee is authorised by Law to invest trust money.

(b) Securities issued by State-aided Railways as have been notified by the Governor-General in Council

(c) Debentures or other Securities issued under any Act of a Legislature in British India by or on behalf of, a District Board, or Municipal Board.

(d) Debentures of companies with limited liability registered in India or elsewhere.

(e) Goods which or documents of title to which thereto were deposited with, or assigned to, the Bank, as security for such advances

(f) Accepted Bills of Exchange or Promissory Notes

(g) Fully paid up shares of companies with limited liability or immovable property of documents of title relating thereto as collateral security where the original security is one of those specified in 'a' to 'e' and, if authorised by the Central Board, in 'g'

(1) (b) With the sanction of Provincial Government, advancing money to Court of Wards upon security of estates in their charge provided that the period for which such advance or loan is made shall not exceed nine months in the case of advances relating to the financing of seasonal agricultural operations or six months in other cases

Borrowing Powers:

The Bank was permitted to:—

(a) Borrow money in India for the Bank's business.

(b) Borrow money in England for the Bank's business only upon the security of the assets of the Bank

Dealings in Bills of Exchange:

The Bank was permitted to —

(a) Draw, accept, discount, buy, and sell bills of exchange and other negotiable securities payable in India, subject to the direction of the Governor-General in Council, Discount, buy, and sell bills of exchange, payable outside India for, from, and to only such Banks as the Governor-General in Council may approve

(b) Draw bills of Exchange and grant letters of credit payable out of India for the use of principals in connection with receiving deposits and keeping cash accounts and also for private constituents for **bona fide** personal needs

(c) Buy, for the purpose of meeting such bills or letters of credit, or bills of exchange payable out of India at any usuance not exceeding six months

Banking business:

(a) Receive deposits and keep cash account

(b) Receive securities, plate, jewels, title deeds or other valuable goods for safe custody

(c) Transact pecuniary agency business on commission

Other business:

(a) Buy and sell gold and silver, coined or uncoined.

(b) Selling such properties movable or immovable, as may come into Bank's possession in satisfaction of claims

(c) Invest the funds of the Bank upon any of the securities specified in (a) to (c) in clause 1.

The Act of 1920 also imposed certain restrictions under which the Bank was prevented from (1) making loan or advance for a period longer than six months upon the security of the shares of the Bank except in the case of advances to Court of Wards, upon mortgage or security of immovable property, or documents of title relating thereto. (2) The amount which may be advanced to any individual or partnership was limited and advances could be made only on the two kinds of securities specified in (a) (b) (c) and (d)

of (1) Under Advances (3) The Bank was not permitted to make discounts or grant advances on personal security unless such discounts and advances carried with them the several responsibilities of at least two persons of firms unconnected with each other in general partnership

The Bank continued to function under the Act of 1920 till it was amended in 1934 on the establishment of the Reserve Bank of India as the Central Bank of the country. That brings us to the third stage of the Bank's history

The Imperial Bank after 1934:

The capital of the Bank was increased to Rs $11\frac{1}{4}$ crores, half of which is paid up and the other half a reserved liability The fully and paid up capital is composed of 75,000 shares of Rs 500/- each and fully paid Rs 1,50,000 shares of Rs 500/- of which Rs 125 is paid The Reserve Fund of the Bank stood at Rs. 5 47 crores The Bank had been paying a dividend of 16 per cent upto 1931 and thereafter it has been paying a dividend of not less than 12 per cent.

The Bank has a Central Board and three local Boards elected by the Shareholders at Bombay, Madras, and Calcutta The Central Board consists of 16 members. They are the (1) Presidents, Vice-Presidents, and Secretaries of the Local Board. (2) Three Directors representing the Shareholders of the Local Boards, (3) Two non-official nominees of the Governor-General (4) An Officer appointed by the Central Government (5) The Managing Director and the Deputy Managing Director appointed by the Central Board for a period of five years, the appointment being renewable thereafter for further periods of five years each time

The Central Board has no fixed location and it holds its meetings either at Bombay or at Calcutta The Managing Director is the Chief Executive of the Bank The Deputy Managing Director also attends the meeting but votes only in the absence of the Managing Director The functions of the Bank are laid down in Bye-Laws, and the Central Board deals only with matters of general policy "such as the movement of funds from one place to another and the publication of the weekly statement"

By the amending Act of 1934 not only the restrictions imposed on the Bank by the earlier Acts have been removed but the Bank itself has ceased to be a Government Banker and a Bankers' Bank, though it continues to function under the special Act

The Bank is free to open its branches wherever it thinks advantageous, it can buy and sell foreign bills of exchange or usuance not exceeding nine months if they relate to the financing of the seasonal agricultural operations, and six months in other cases, it can open cash credits, receive deposits and, borrow money outside India, it can make advances against goods hypothecated to it instead of being restricted to advances only against goods which are in its possession or the documents of title to which are deposited with it, and, finally, it can make advances and open cash credits on the security of the shares of the Reserve Bank of India or on the Security of debentures issued under the authority of a Municipal Board or Committee, or with the sanction of the Governor-General in Council, or on debentures issued under the authority of the ruler of an Indian State, or subject to the directions of its Central Board, or on debentures or fully paid-up shares of Companies with limited liability registered in India

Even after 1935, when the restrictions imposed upon the Imperial Bank were removed enabling the Bank to act like any other commercial bank, the Bank still continues under the special Act.

The Imperial Bank in the Banking System:

The Imperial Bank of India occupies a unique place in the banking system of the country The vastness of its resources, its intimate connection with the Government, the high liquidity of its assets, and the great profits it has been making[1] are factors which have given it the position it now occupies

Before the establishment of the Reserve Bank of India, (1933), its total deposits were greater than the deposits of all the joint-stock banks, its private deposits alone being a little higher than the deposits of these joint-stock banks Even as late as in 1940, its private deposits were nearly equal to the deposits of Indian joint-stock banks ('A' class)

The result of the long patronage it has been able to enjoy from the Government by means of the grant of inte-

(1) Year	Dividend declared	Year	Dividend declared
1921	16 per cent	1928	16 per cent
1922	16 "	1929	16 "
1923	16 "	1930	16 "
1924	16 "	1931	14 "
1925	16 "	1932	12 "
1926	16 "	1933	12 "
1927	16 "	1934	12 "

rest-free balances has been that the public have placed their confidence in the Bank The fact that the Bank has been able to make a profit greater than any other Bank and, at the same time, maintain a high degree of liquidity of its assets, probably accounts more for this public confidence than the interest-free balances It is true that it had to maintain appreciable liquid assets as it was in the nature of a Central Bank in the absence of such an institution But a more cogent reason seems to be that restrictions imposed on it in the matter of discounts and advances compelled it perforce to maintain a high degree of liquidity It is, therefore, true to state that more than the interest-free balances it was the liquidity of its assets that accounted for its huge business After all, the *interest-free balances accounted* only for a fraction of its total deposits The Bank had, from the beginning, followed a policy of opening a number of branches, and, later on, at the instance of the Government, it opened many more and thus ensured for itself a very wide area for its activities By this policy, be it said to its credit, it extended banking facility to the remote corners of India It had the largest number of branches by the year 1926, in 1941, it had 401 branches, and even in the year 1947-48, the Imperial Bank branch is perhaps the only banking institution in many places in India.

In the absence of a Central Bank, the Imperial Bank had to take up the leadership of the banking system, which it did, for which it was well-suited. Joint-Stock banks had their accounts with it and so were the Exchange Banks. Not that the Indian Banks had implicit faith in its leadership In fact, they felt, and complained of, competition from the Imperial Bank [1] But still its conspicuous position was beyond dispute As a Bankers' Bank, it did not fail in its obligations to banks when they were in difficulties and needed help [2] But what the Indian Banks resented was the alleged step-motherly treatment meted out to them on racial and political grounds The Imperial Bank, it was alleged, was discriminating against Indians and this it was pointed out, was evident even from the composition and management of the Bank

As a leader of the banking system, to the lot of the Imperial Bank fell the regulation of the monetary condi-

(1) Minutes of evidence taken by the Royal Commission on Indian Currency and Finance, Volume V, Q 12053—12077

(2) Minutes of Evidence, Royal Commission on Indian Currency and Finance, Volume IV, page 400.

tions In order to assist the money market in the busy season when the Bank rate usually rose high, the paper currency department was allowed to grant loans to the Imperial Bank upto a maximum of Rs 12 crores, of which Rs 4 crores was at 6 per cent, the remaining Rs 8 crores at 7 per cent During the busy season, the Imperial Bank financed the marketing and movement of goods by discounting **hundis** to indigenous bankers and the banks had to lower their discount in those places where the Bank opened its branch—thus making its presence felt in the discount market Accordingly, Joint-Stock Banks complained of competition by the Imperial Bank in the matter of discount rates offered by the latter

The fact that, even after establishment of the Reserve Bank of India the Imperial Bank has continued to be governed by the special Act, has been criticised by the public It has been asked, for instance, why the Imperial Bank itself was not converted into a Central Bank? The question is often asked why a bank which had built up such a mighty organisation, and which, in practice, was a Central Bank, was not converted into a Central Bank The Hilton Young Commission considered the whole question and came to the conclusion that to dismantle the Bank of its commercial functions would arrest the progress of the country in the one sphere where the progress was most urgent and vital In addition, Central Banking functions are never consistent with commercial banking functions, particularly when, in the discharge of the former functions, it has to act as a bankers' bank Further, where a Commercial Bank works solely for profit, a Central Bank has to forego the same in the national interest Though the Hilton Young Commission did not favour the conversion of the Imperial Bank into a Central Bank, the Indian opinion was in favour of it This was because they feared that after the establishment of the Reserve Bank of India, there would be two institutions working under special Acts, and enjoying special privileges, unknown in any other country of the world Fears were also expressed whether the Imperial Bank of India, an erstwhile competitor of the Commercial Banks, could work as bankers' bank effectively However, the controversy was set at rest with the decision of the Government to establish a new institution—the Reserve Bank of India and hand over Central Banking functions to it

The Imperial Bank of India as agent of the Reserve Bank of India.

As though in reward for the past services rendered by the Imperial Bank of India, it has been appointed as the agent of the Reserve Bank of India. For this purpose, the Imperial Bank has entered into an agreement with the Reserve Bank which will remain in force for 15 years and thereafter until terminated by five years' notice on either side Under the terms of the agreement, the Imperial Bank is appointed as the agent of the Reserve Bank of India at all places in British India where there is a branch of the Imperial Bank of India and where there is no branch of the Reserve Bank of India (Banking Department) The Imperial Bank is to be paid for performing these agency duties on behalf of the Reserve Bank of India a commission calculated at 1/16 per cent for the first ten years of the pendency of the agreement on the first 250 crores and at 1/32 per cent on the remainder of the total receipts and disbursements dealt annually on account of the Government The rate of commission for the next five years is to be decided on the basis of the actual cost to the Imperial Bank as ascertained by expert accounting investigation For having maintained the branches for a period of 15 years, the Reserve Bank shall pay to the Imperial Bank sums not exceeding Rs 9 lakhs during the first five years, and Rs 6 and 4 lakhs during the next two five-year periods

THE IMPERIAL BANK OF INDIA (from 1921 to 1934)

Year As on 31st December	Paid up Capital	Reserves	Total	Public Deposits	Private Deposits	Total	Cash on hand and in Banks	Investments in Govt and other Securities	Loans and advances and Bills discounted	Number of Branches
1921	5 02	4 02	9 64	6 80	65 78	72 58	13 68	12 46	53 90	88
1922	6 63	4 23	9 86	14 16	57 00	71 16	15 07	9 79	54 51	106
1923	5 63	4 45	10 08	8 57	74 20	82 77	15 01	12 18	70 71	149
1924	5 63	4 08	10 31	7 50	76 71	84 21	15 60	16 37	61 40	165
1925	5 63	4 83	10 46	5 47	77 83	83 30	17 47	17 01	56 45	181
1926	5 63	5 00	10 63	6 45	73 90	80 35	20 00	19 15	48 02	186
1927	5 63	5 13	10 76	7 20	72 07	79 27	10 89	18 59	61 53	198
1928	5 63	5 23	10 86	7 95	71 30	79 25	10 58	21 76	61 60	202
1929	5 63	5 33	10 96	7 60	71 64	79 24	14 00	33 00	40 59	208
1930	5 63	5 39	11 02	7 37	76 60	83 07	13 04	28 25	49 58	206
1931	5 63	5 00	10 63	8 32	63 86	71 18	11 04	30 27	41 58	201
1932	5 63	5 17	10 80	7 07	69 36	76 43	20 97	32 04	30 60	201
1933	5 63	5 23	10 86	6 44	74 13	80 57	18 60	47 03	22 59	202
1934	5 63	5 35	10 98	6 72	74 28	81 00	18 97	41 50	20 02	221
1935	5 63	5 47	11 10		79 10		10 59	46 80	21 58	228
1936	5 63	5,50	11 13		78 80		8 78	52 59	26 76	269
1937	5,63	5 50	11 13		81 08		13 43	47 62	29 37	310
1938	5 63	5 55	11 18		81 71		8 90	43 73	38 30	378
1939	5 63	5 60	11 23		87 84		11 09	38 02	48 88	381
1940	5 63	5 63	11 25		96 03		24 83	48 57	32 31	390
1941	5 63	5 63	11 25		108 92		15 27	64 30	38 88	401
1942	5 63	5 75	11/38		163 16		23 00	116 41	33 79	392
1943	5 63	5 85	11 48		214 53		53 36	130 20	40 60	398

CHAPTER X

COMMERCIAL BANKING

INDIAN JOINT-STOCK BANKS

Strictly speaking, banking institutions like the Imperial Bank and Exchange Banks are also Commercial Banks, though the term "Commercial Bank"[1] is generally applied to Joint-Stock Banks registered under the Indian Companies Act. And Indian Banking Companies Act

In India, there is no special law governing banking institutions The provisions of the Indian Companies Act are generally applicable with certain additional clauses relating to banking companies Prior to the amendment Act of 1936 to the Indian Companies Act, a banking Company was distinguished from other companies, in that the Act prohibited partnership of a banking company if it consisted of more than 10 partners, whereas, in other cases, the number of partners was allowed to be 20 The Act also required banking companies to file with the Registrar of Companies a list of its places of business as well as their periodical statements and balance sheets In the balance sheets, the banks were required to show the secured and unsecured debts separately. A further provision of the Act required the appointment of Inspectors on the application of members holding shares of the value of not less than one-fifth of the issued shares to examine the affairs of the Company

These provisions were inadequate and, therefore, the Central Banking Enquiry Committee recommended the enactment of a special Act to govern banking institutions. The foreign experts associated with the Central Banking Enquiry Committee did not favour a special Act, but recommended that suitable amendments to the Indian Companies Act should be made.

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(1) See Appendix IV for the Balance Sheet of a Commercial Bank

The Government of India amended the Indian Companies Act in 1936, and, as amended, the Act contains important provisions to regulate banking companies.

In the first place, the amended Act defines a banking company as a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order A banking company is permitted to do all other business incidental to its principal functions*

Section 277F of the Indian Companies Act provides that no company formed after (1936) the commencement of the amendment Act which proposes to carry on the business of Banking and adds for that purpose to its name words like "Bank", "banker" or "Banking" shall be registered unless it limits in its memorandum of association its functions to the acceptance of deposits, current or otherwise, subject to its withdrawal by cheque, draft or order. The amendment Act also prohibited the appointment of a managing agent for a banking company Further, certain restrictions are imposed if a banking company has to commence its business Thus the Act provides that a banking company shall not commence business, unless it has a sum subscribed as its share capital an amount of Rs 50,000 and unless it has filed an affidavit signed by two directors and the manager to that effect A banking company, other than a scheduled bank, is required to maintain 1½ per cent of its time and 5 per cent of its demand liabilities, in cash A further provision lays down that no banking company shall form any subsidiary company for the purpose of undertaking the execution of trusts, administration of estates, as executor trustee or otherwise, except that it can undertake the same as is provided in Sec 277F incidental to its ordinary business

Joint-Stock Banks are classified into four groups To the first group belong the scheduled and non-scheduled banks, having a capital and reserves of more than Rs 5 lakhs each. To the second group belong banks which have capital and reserves between Rs 5 lakhs and Rs 1 lakh each To the third group belong those banks which have capital and reserves between a lakh of rupees and Rs 50,000/- To the last group belong Banks which have each capital and reserves of less than Rs 50,000

* See Appendix II

The following figures show the position of the four classes of Banks at the end of 1945 —

(In thousands of Rupees)

Class	No. of Reporting Banks.	Capital and Reserves	Deposits.	Cash on hand and in Banks	Bills discounted and Loans	Investment in Government and other Securities
A	143	45,08,54	6,01,17,11	1,27,01,00	2,46,21,26	2,97,93,20
B	174	3,61,10	32,04,69	9,50,32	18,44,65	8,25,14
C	114	80,29	7,44,60	2,03,77	4,60,76	1,53,05
D	244	49,10	4,19,42	1,21,76	2,82,44	49,69

Source Statistical Tables relating to Banks in India 1944 and 1945

Business of Commercial Banks:

The Commercial Banks in India engage themselves in the distribution of credit—the same purpose as is fulfilled by co-operative banks in rural areas Commercial Banks in India do not have the right of note issue which is essentially the function of the Reserve Bank Nor are they playing any adequate part in the financing of foreign trade The share of the Indian Banks with regard to industrial finance is not much The result is that they are mainly concerned with the distribution of commercial credit For this purpose, they pool the national savings First, they obtain funds by share capital and, secondly, by means of deposits The deposits may be fixed, savings or demand deposits Only a few big banks have savings deposits, while a large number of smaller banks accept savings deposits. The banks augment their resources by means of the reserve fund they build by setting apart a portion out of their annual profits But the bulk of their funds comes from the deposits In mobilising deposits thus, the Commercial Banks render invaluable service to the economic life of the community.

Factors governing the volume and size of bank deposits are many In the first place, it depends generally upon the capacity of the people to save, and, therefore, upon the level of income of the people, and secondly, upon the banking habit It also depends upon the faith the people have in the banking institutions and upon the facilities offered by the latter to the public People generally look to security first and profitability next in countries like India where banking has not developed well The size and the volume of bank deposits depend essentially upon the extent to which people prefer to invest their savings in banks as compared

to investing in other agencies A large volume of the annual national savings of the people is invested in building activities A part is invested in industry. This amount, however, reappears as the industries keep a large portion of their cash in a liquid form, that is, by way of current deposits in Banks Some portion of the national savings is invested in insurance companies by means of insurance premia A portion is invested in precious metals In fact, it was brought to the notice of the Central Banking Enquiry Committee that India absorbed large quantities of silver and gold, every year This would appear to be an exaggeration if the flow of precious metals into other countries were taken into consideration In recent years, the Government has become a competitor, as the borrowings of the Government have increased Post Office Savings Banks and Postal Cash Certificates, together with Port Trust and Municipal Loans, absorb a considerable amount of the savings of the people The Post Office Savings Bank account increased from 22 86 crores in 1920-21 to 81 94 crores in 1938-39 Similarly, the amount invested in cash certificates increased from 4 34 crores in 1920-22 to 59 57 crores in 1938-39 In the subsequent years the deposits in these have declined The decline is due as deposits in Post Office Defence Savings, Post Office National Savings Certificates, Post Office Defence Savings Bank have increased considerably

But since then the investment in these is not keeping pace with the speed with which the Bank deposits are increasing During the War period, the deposits of Banks increased enormously in spite of the heavy Government borrowing and other factors This is due partly because savings could not find any outlet either in building activities or for the importation of goods due, in either case, to respective restrictions thereon The amount of funds invested in Postal Savings and Cash Certificates has fallen low*, probably because the public prefer to invest their

* (in lakhs of Rupees)

Year	Postal Savings and Cash Certificates	Year	Bank Deposits (all banks)	Bank Deposits (Joint-stock Banks)
1938	140,28	1938	255,92	106,81
1941	102,26	1941	364,74	149,09
1942	90,26	1942	498,66	218,35
1943	108,11	1943	714,60	359,88
	(fall of 23%)		(a rise of 179 6%)	(a rise of 360%)

savings in Government loans in preference to depositing them in banks It further reflects the structural changes in the Banks' deposits. The huge deposits in the Banks are probably owned more by big firms and corporations than by individual savers While time deposits are practically at a standstill, the demand deposits are moving at a rapid rate. In the year 1945-46 the Demand deposits were twice the amount of the time deposits We have no figures showing exactly how much of the Banks' deposits are to the account of firms and business corporations and how much to that of individual depositors If the amount invested in the postal savings and cash certificates is any index of the saving capacity of the people, then it is clear that it has reached the lowest ebb.

A further factor governing the size of banking deposits and the growth of banking institutions generally is the general economic condition of the country. In a period of boom and rising prices, Banks prosper and create additional credit on the basis of their deposits But when the depression sets in, the Banks recall the loans they have made, as they would be required to keep their position sound. The volume and the size of bank deposits also depend upon the interest rates paid by the Banks

The deposits may be demand, time, or savings deposits. Demand deposits are those on current account payable on demand by cheque or by any other means as may be adopted, and time deposits are those which are payable after some specified period In one sense, savings accounts (deposits) also belong to the latter category. The following figures show the growth of different kinds of deposits of the Scheduled Banks:

Scheduled Banks*

(in Crores of Rupees)

Year	Number of Banks	Demand Deposits	Time Deposits	Savings Deposits	Percentage of Demand to total deposits
1938-39	55	129 98	107 85		54 7
1939-40	59	139 65	105 03	38 15	56 8
1940-41	63	168 90	104 94	37 58	66 0
1941-42	59	211 35	107 61	37 24	74 6
1942-43	61	306 28	104 21	48 30	76 2
1943-44	75	456 63	142 78	68 03	75 1
1944-45	84	584 60	194 12	90 58	71 6
1945-46	91	654 53	259.52	121 56	69 2

* These figures are inclusive of the figures for Exchange Banks and the Imperial Bank No figures are available for Indian Scheduled Banks as

The following table shows the growth of demand and time deposits of the non-scheduled banks submitting the returns under the Indian Companies Act:—

(in Crores of Rupees)

Year	Number of Banks	Demand Deposits	Time Deposits.	Percentage of demand to total deposits
1939	669	4 87	11 09	30 5
1940	604	5 26	11 48	31 4
1941	601	7.06	12 47	36 2
1942	534	11 06	13 59	44 9
1943	530	17.52	17.27	50 4
1944	618	24 84	28 29	16 8
1945	632	33 92	39 71	46.1
1946	659	32 79	45 65	41 8

Commercial Banks in India pay interest on deposits The interest paid on current (demand) deposits differ from

such in regard to the demand, time and savings deposits, showing these items separately. However, a large number of Scheduled Banks do not hold savings deposits as such Of the 76 Scheduled Banks in 1945 as many as 14 banks held savings deposits Of the Non-Scheduled Banks with capital and reserves of Rs 5 lakhs and over numbering 68, as many as 28 banks held savings deposits and out of the total number of 174 Banks with capital and reserve between Rs 5 lakhs and 1 lakh as many as 16 banks held savings deposits in 1945 Out of 114 banks with capital and reserves between Rs 1 lakh and Rs 50,000 as many as 31 alone held savings accounts at the end of 1945

Distribution of demand and time deposits and the percentage of demand to total deposits

(figures in 000,000)

	1938			1931			1943			1945		
	Demand Deposits	Time Deposits	% of demand to total Deposits	Demand Deposits	Time Deposits	% of demand to total Deposits	Demand Deposits	Time Deposits	% of demand to total Deposits	Demand Deposits	Time Deposits	% of demand to total Deposits
Australia	119 3	197 5	87 58	121 6	199 9	87 8	260 9	201 9	56 49	302 4	224 6	61 6
Canada	690	1630	29 74	742	1699	30 36	1619	1804	46 48	1986	2750	41 91
U S A	24836	5252	82 21	28886	5389	84 24	53487	6205	89 94	68237	9373	87 92
S Africa										286 9	35 5	89 57

those paid on fixed (time) deposits. However, the Imperial Bank does not pay any interest on current account The Exchange Banks and other banks do pay interest on current accounts In the case of savings deposits Banks insist on a minimum balance to be maintained by the customer and restrict the withdrawal both in regard to the time and the amount. The larger Banks in Bombay paid interest at rates varying from ¾% (January) to 2½% (Aug-Sept) on deposits for three months, from 2¼ (Dec-Jan) to 1¼ (Aug-Sept.) per cent on deposits for six months and from 1½ (Dec-Jan) to 2 (Aug-Sept) per cent for deposits for a year and over in the year 1938-39 In recent years the rates have declined in that in the year 1946-47 the highest rate paid by any Bank in Bombay was not above 1¾ per cent (Mar.-Apr-March). While it is true that bigger banks in Bombay pay lower rates of interest, it is equally true to say that smaller banks in the mofussil pay higher rates of interest They do so probably to attract deposits and augment their resources

The Commercial Banks distribute credit either by means of loans and advances or by discounting bills Commercial Banks in India advance loans against gold and valuables practically unknown to Western Bankers They also advance to a limited extent to merchants and exporters on agricultural produce They also advance loans on the security of land and buildings Most of the Commercial Banks offer remittance facilities, while some undertake even executor and trustee business Some smaller Banks conduct what are known as kuris and chit funds business.

In the case of loans and advances the borrower undertakes to pay and no time limit is set generally. In the case of discounts of bills the accepting bank or the acceptor undertakes to pay to the discounting house or bank within a specified period, that is, on the maturity of the bill and the bank or the individual discounting the bill will charge interest for the intervening period between the date of payment or discount by the Bank and the date of maturity or the date of payment by the original acceptor or the accepting house or Bank.

The following figures show the relative position of loans and advances to bills —

Scheduled Banks*

(in Crores of Rupees)

Year	Loans and advances	Percentage to total deposits	Bills discounted	Percentage to total deposits
1938-39	115 85	48 71	4 86	2 04
1939-40	125 89	51 24	5 25	2 14
1940-41	122 13	45 43	3 84	1 43
1941-42	120 20	37 68	4 98	1 35
1942-43	95 68	23 30	2 18	0 53
1943-44	156 14	26 05	5 59	0 93
1944-45	224 22	28 78	11 16	1 44
1945-46	285 07	31 19	16 05	1 75

*All Scheduled Banks

Non-Scheduled Banks—Loans and Advances including bills discounted

(in Crores of Rupees)

Year	Banks with capital & Reserves of Rs one lakh & over			Banks with capital & Reserves between Rs one lakh & Rs 50,000			Banks with capital and Reserves of less than Rs 50,000		
	No of Banks	Amount	% to total deposits	No of Banks	Amount	% to total deposits	No of Banks	Amount	% to total deposits
1939	181	14 18	86 9	112	2 65	88 9	400	2 6	108 7
1940	189	13 68	72 9	121	2 59	90 6	332	2 32	108 7
1941	144	14 58	72 7	124	3 09	78 6	147	0 84	85 8
1942	161	17 56	60 5	187	3 40	68 7	133	0 69	100 0
1943	187	22 45	55 8	141	4 12	65 8			
1944	211	38 53	50 6	118	3 76	64 5	285	2 47	70 8
1945	242	43 75	47 5	114	4 61	61 9	244	2 82	67 3

In relation to deposits the percentage of loans and advances including Bills discounted of the Scheduled Banks fell from 53 38 in 1939-40 to 23 83 in 1942-43 However there was a steady increase and in 1945-46 it stood at 32.94.

Percentage of Loans and Advances to total deposits

Data Entered
4 JUN 2004

	1938	1939	1943	1945
Australia (9 Banks)	89 75	90 42	50 02	35 16
Canada	42 0[illegible]	41 [illegible]4	[illegible]	[illegible]
U S A	28 1[illegible]	25 14	[illegible]	18 57
Imperial Bank	47 0[illegible]	55 00	18 9	28 [illegible]

The percentage of loans and advances including bills discounted of non-scheduled banks with capital and reserves of Rs 1 lakh and over fell from 86 9 in 1939 to 55 8 in 1943 and to 47.5 in 1945. The percentage of loans and advances including bills discounted of non-scheduled banks with capital and reserves between Rs 1 lakh and Rs 50,000 and those with capital and reserves of less than Rs. 50,000 fell from 88 9 and 108.7 in 1939 to 61 9 and 67.3 respectively in 1945.

Investments form an important assets item in a Commercial Bank's portfolio Generally Banks in India invest their funds in Government securities partly because they consider it most liquid, that is, they can realise cash at short notice and without much loss in capital invested, and partly because such securities would serve as the basis for loans from the Reserve Bank at the bank rate.

The following figures show the position of investments of the Scheduled Banks and Non-Scheduled Banks

Scheduled Banks *

(in Crores of Rupees)

Year	Investment in Government and other securities	Percentage of Investments to total deposits.
1939	36 51	38 9
1940	42 45	40 0
1941	58 52	45 4
1942	101 77	53 7
1943	164 25	51 4
1944	231 41	53 2
1945	278 52	51 5

Non-Scheduled Banks

Year	Banks with capital and Reserves of Rs 1 lakh and over		Banks with Capital and Reserve between Rs 1 lakh and Rs 50,000		Banks with Capital Reserves of less than Rs 50,000	
	Amount	Per cent to total deposits	Amount	Per cent to total deposits.	Amount	Per cent to total deposits
1939	4 59	28 2	42	14 1	23	8 7
1940	4 83	25 5	44	15 4	25	9 2
1941	5 80	28 9	65	16 5	70	8 3
1942	8 32	28 7	80	16 2	6	8 0
1943	10 04	24 9	1 05	16 8		
1944	16 56	25 0	1 18	20 2	35	10 0
1945	27 66	30 0	1 53	20 5	50	11 0

* Excluding the figures for Exchange Banks and the Imperial Bank.

From the above figures it is clear that the investments of the Scheduled Banks (excluding the Imperial Bank) have increased from 38 9 per cent in 1939 to 51 4 in 1943, and to 51 5 in 1945 The pre-war percentage for the year 1938 was 43 1 The percentage of investments to total deposits of non-scheduled banks with capital and reserves of Rs 1 lakh and over declined from 28 2 in 1939 to 24 9 in 1943 and improved to 30 0 in 1945 The pre-war percentage for the year 1938 was 22 8 The percentage of investments to total deposits of non-scheduled Banks with capital and reserves between Rs 1 lakh and Rs 50,000 and of those banks with less than Rs 50,000 increased from 14 1 and 8 7 in 1939 to 20 5 and 11 9 respectively *

Finally we come to the cash position. Generally banks in India maintain a higher percentage of cash to total deposits either in their own vaults or as balance with other banks, or with the Reserve Bank to meet the demand of the depositors whenever the demand arises The following table shows the position of Scheduled Banks and Non-Scheduled Banks —

Scheduled Banks

(in Crores of Rupees)

Year	Amount	Percentage to total deposits
1939	16 12	17 2
1940	25 02	23 6
1941	24 21	18 8
1942	48 77	23 1
1943	76 77	23 9
1944	89 65	20 6
1945	105 59	19 5

* Percentage of investments to total deposits (Commercial Banks)

	1938	1939	1943	1945
Canada	50 1	50 66	58 22	
Australia	12 96	11 35	31 30	
U S A	54 42	51 13	81 61	
Imperial Bank	58 6	43 80	60 70	59 4

Non-Scheduled Banks

(in Crores of Rupees)

	Banks with Capital & Reserves of Rs 1 lakh and over		Banks with Capital & Reserves between Rs 1 lakh & 50,000		Banks with Capital & Reserves of less than Rs 50,000	
	Amount	Per cent to total deposits	Amount	Per cent to total deposits	Amount	Per cent to total deposits.
1939	1 98	12 2	52	17 4	38	14 4
1940	3 48	18 4	59	20 6	47	17 3
1941	4 16	20 7	98	24 9	18	15 5
1942	8 12	28 0	1 56	31 5	18	17 3
1943	13 05	32 4	1 97	31 5		
1944	23 64	35 7	1 60	27 4	1 04	29 8
1945	30 93	33 6	2 04	27 4	1 22	29 1

While it cannot be denied that Banking has been progressing well in India, it is pointed out that certain improvements are necessary, for the development hitherto has been lopsided and banks have concentrated in certain places unduly in large numbers, while some other places have no banking facility at all.

In the first place, India is an agricultural country with the village as a unit and it is, therefore, necessary that Commercial Banks should open their branch offices in village produce-assembling centres as far as possible The Commercial Banks at present have a tendency to open their branches in bigger commercial and industrial centres or towns and compete with each other for business Some big cities like Bombay, Calcutta, and Madras have branches of all sorts of Banks It is only the Imperial Bank which has distributed its branch offices in all produce-asembling towns as well as big commercial towns

Percentage of Cash to total Deposits

	1938	1939	1943	1945
Australia (9 Banks)	11 11	10 51	8 35	6 54
Canada (10 Charteerd Banks)	10 2	10 2	11 1	
U S A	25 59	20 02	15 57	13 80
England and Wales (London Clearing Banks)	10 8	11 2	10 5	
Imperial Bank	11 0	24 9	16 0	
Exchange Banks (in India)	10 0	27 8	28 5	

Indian joint-stock banks should practise economy of management, and branch offices should not be opened indiscriminately The test of a bank's solvency is not the number of branch offices it has opened In India, joint-stock banks are in the practice of opening branch offices with the object of attaining a conspicuous position

The banks should take part adequately in the distribution of manufactured and imported articles in the interior places It is true that, with the opening of sale-shops and branch offices by industrial concerns and importing houses, the petty trader and merchant has lost much of his business and, therefore, he no longer needs the same degree of assistance of banks, particularly in the matter of credit facilities as a stop-gap accommodation against his stock, as before Even so, the cheap bank credit would enable the petty trader of the village or town to hold on to business and smoothen the flow of manufactured goods to the advantage of the consumers

The joint-stock banks in each place should form themselves into an association and regulate their business practices, in the light of local circumstances, particularly in the matter of the rates of interest, etc Such an association would enable the banking offices of the place to develop to the advantage of all The race for attracting deposits by paying even uneconomical rates of interest would then cease This particularly applies to smaller banks which have a great future in this country provided they are equitably distributed all over the country

Each bank, or a number of banks together, should set up or have an Intelligence, Statistical and Research Department to study the economic and banking conditions in the country or even in the district or place where they are operating, and this will largely help them adjust their credit policies and the policy of opening branches Further, they would be in a better position to advise their clientele in the matter of sale, purchase, and investment problems

CHAPTER XI

THE RESERVE BANK OF INDIA

The need for a Central Bank:

The need for a Central Bank to control and co-ordinate currency and credit was felt from a very long time Attempts made earlier had failed. With the publication of the Report of the Royal Commission on Currency and Banking (1925) the problem assumed importance once again A bill was introduced in the Central Assembly providing for the establishment of a Reserve Bank of India, but, after a great deal of controversy, particularly as to whether it should be a State Bank or a Shareholders' Bank, the bill was abandoned in 1928 by the Government

With the inauguration of the Federation in 1935 and the grant of complete fiscal autonomy, it was considered that a Central Bank must precede such financial independence Hence the Reserve Bank of India Act was passed, and it received the assent of the Governor-General in 1934.

The object of the Bank, according to the preamble to the Act, is

(1) to regualte the issue of Bank Notes and the keeping of Reserves with a view to securing monetary stability in British India, and

(2) to control the currency and credit system of the Country to its advantage

The preamble to the Act does not lay down any monetary standard and the decision regarding it is left to a later date when international conditions would be clear.

Structure, Ownership, Control and Constitution:

The Reserve Bank is a Shareholders' Bank on the model of Central Banks of many countries,* having an autho-

* The following Central Banks are Shareholders' Banks .—

The Netherlands Bank, The National Bank of Belgium, Reichs Bank of Germany, The Bank of Japan, The Bank of Norway, The Bank of Spain, The Bank of Portugal, The National Bank of Hungary, The National of Yugoslavia, the National Bank of Roumania, The Bank of Greece, and The South African Reserve Bank.

rised and paid-up capital of Rs 5 crores The entire share capital, which is divided into 50 lakhs shares of Rs 100/- each fully paid-up, is offered to the public except shares of the face value of Rs. 2,20,000/- which have been placed at the disposal of the Central Government to be allotted to the Directors of the Central Board for holding qualification shares Every person domiciled in India or an Indian State or a company or a co-operative society registered according to Indian Law can hold shares British subjects ordinarily resident in India but having domicile elsewhere in the British dominions, including the U K. and companies and societies registered in those dominions but having their offices in India can hold shares, provided the country in which such persons have permanent domicile and such companies have their head offices do not discriminate against Indians Separate registers, of shareholders are kept in Bombay, Madras, Calcutta, Delhi and Rangoon, and initially shares have been distributed to these areas to be held by persons ordinarily resident in these areas to prevent accumulation of shares in the hands of persons of one area The initial allotment of shares was as follows (Shares worth)·

	Rs.		Rs		Rs.
Bombay	140 lakhs	Calcutta	145 lakhs	Madras	70 lakhs
Delhi	115 ,,	Rangoon	30 ,,		

The Act prohibits a person from holding shares in more than one register to achieve the same object But, since shares are transferable from one register to another, the shares are slowly moving to the Bombay register as can be seen from the following figures

Distribution of Shares showing dates and percentage of shareholders

	1-4-35		31-12-36		31-12 38		30 6-40		30 6 42		30 6-44		30-6-45	
Bombay	140	28 0	190	22 3	206	20 8	211	19 8	219	18 4	231	18 0	233	17 4
Calcutta	145	23 9	131	15 6	123	13 8	120	12 8	120	11 6	119	11 0	122	19 5
Delhi	115	23 0	97	16 7	93	14 9	91	13 7	86	12 2	85	11 5	88	11 [illegible]
Madras	70	14 0	61	9 7	60	8 7	60	8 2	59	7 7	55	7 1	53	6 8
Rangoon	30	3 1	20	1 9	18	1 6	19	1 4	17	1 2	9	0 6	9	0 6

To prevent further movement of shares, an amendment Act was passed in 1940 by which it was laid down

that no person could hold shares of the total value of more than Rs 20,000

The general superintendence and direction of the affairs of the Bank is entrusted to a Central Board of Directors consisting of 16 members, viz, (a) a Governor and two Deputy Governors appointed by the Central Government after consideration of the recommendations made by the Board in that behalf, (b) four directors nominated by the Central Government, (c) eight directors elected on behalf of the shareholders on the various registers in the proportion of two directors each from the registers of Bombay, Calcutta and Delhi and one each from Madras and Rangoon registers, and (d) one Government Official nominated by the Central Government For each of the five areas there is a Local Board consisting of (a) five members elected from amongst themselves by the shareholders who are on the register for that area and are qualified to vote and (b) not more than three members nominated by the Central Board from amongst the shareholders on the register for that area In exercising the power of nomination, the Board is required to aim at securing the representation of territorial or economic interests not already represented and, in particular, the representation of agricultural interests and the interests of co-operative banks It is interesting to note that there is no provision for the representation of agricultural interests on the Central Board, though India is an agricultural country, as is the case in some Central Banks* It is true that there is no specific representation to any economic interests as such, but, in practice, the business interests are generally represented by sheer force of circumstances This makes it all the more necessary that there should be representatives elected from agricultural bodies

In order to secure the independence of the Central and the Local Board and to ensure that they function free from political influence it is provided that no person can be a

* It is worth drawing attention here to the fact that in some countries there is Statutory representation of specific economic interests on the Boards of Central Banks In Chile one director is to be nominated by the National Agricultural Society and the society for the encouragement of manufacturers acting jointly one by the Association of Nitrate producers and the Central Chamber of Commerce acting jointly and one by the Labour Unions In Peru one director is to be elected by the National Agricultural Societies, one by the Chambers of Commerce and one by the National Society of Industries In Bulgaria four directors are to be elected by the Chambers of Commerce, the Bourse and the Agricultural Boards (De Kock, *Central Banking*, pages 323-24)

Director of the Central or Local Board who (a) is a salaried Government Official or a Salaried Official in a State in India or (b) is, or at any time has been, adjudicated an insolvent, or has suspended payment or has compounded with his creditors or (c) is a director of any Bank other than a Co-operative Bank or (d) is a member of the Central or Provincial Legislature (e) or is found lunatic or becomes of unsound mind Whatever the character of the Bank's executive the Central Banks all over the world have been scrupulously following the dictates of their national Governments, reducing the question of controversy regarding the ownership of the Bank and the character of its executive to the level of academic discussion

The Reserve Bank is prohibited from competing with the Commercial Banks in the matter of acceptance of deposits from the public, or making loans to them either on mortgage of property or other security of immovable property or documents of title relating thereto, or draw or accept bills payable otherwise than on demand or allow interest on deposits or current account, or become the owner of immovable property except in so far as it is necessary for its own business purposes Nor can it engage in trade or otherwise have a direct interest in any commercial, industrial or other undertaking except such interest as it may acquire in the satisfaction of any of its claims provided that all such interests are disposed of as early as possible It is also prohibited from purchasing its own shares or shares of any other Bank or Company or grant loans upon the security of any such shares

The Bank is permitted to declare a dividend* of not more than 5 per cent after providing for certain items of expenditure After payment of dividend at the rate fixed by the Government, the balance goes to the Government account

The functions of the Bank may be studied under (a) Central Banking Functions and (b) Other functions —

(A) CENTRAL BANKING FUNCTIONS

(a) The Issue of Bank Notes

The Reserve Bank has been given the sole *monopoly* of the issue of Bank notes It is recognized that it should be regulated by a Central Banking authority For this purpose, the Reserve Bank maintains a separate department known as the Issue Department, as distinct from the Bank-

* Dividend was paid at 3½ per cent till 1942 The rate was raised to 4 per cent by an Ordinance in 1943

ing Department In so doing, it has copied the Bank of England The assets of the Issue Department consist of gold coin, gold bullion, sterling securities, rupee coin and rupee securities. Of the total assets, not less than 40 per cent under Law must consist of gold or Sterling securities, provided the value of gold bullion is not less than Rs 40 crores in value. But, with the previous sanction of the Central Government, the Bank may hold gold coin, gold bullion or sterling securities of less than 40 per cent The value of gold is based on the Statutory valuation of 8 47512 grains per rupee or Rs 21-3-10 per **tola.** The rupee coin is to be valued at its face value and the Government Securities at their market value for the time being The Sterling securities the Bank is permitted to hold in its Issue Department are limited to (1) balances held with the Bank of England, (2) Bills of Exchange bearing two or more good signatures drawn and payable at any place in the United Kingdom and having a maturity of not exceeding 90 days, (3) Government Securities of the United Kingdom maturing within five years

(b) A Bankers' Bank:

The next important function of the Bank is the regulation of Banking The control is sought to be exercised by including in a schedule (Schedule II to the Act) a certain number of banks which maintain with the Reserve Bank a minimum balance of 5 per cent of their demand and 2 per cent of their time liabilities The banks entitled to be included in the Schedule and called as Scheduled Banks must have capital and reserves of not less than Rs 5 lakhs The accumulation of these balances with the Reserve Bank places it in a position to use them freely in emergencies to support the Scheduled Banks themselves, in times of their needs as the lender of the last resort To a certain extent, it is also possible for the Reserve Bank to influence the credit policy of the Scheduled Banks by means of open market operations policy, viz., by the purchase and sale of securities or bills in the market The Reserve Bank has another instrument in the form of the Bank rate, which it publishes from time to time The Bank rate of the Reserve Bank has remained at 3 per cent ever since its inception The relations of the Reserve Bank in the banking system is confined to Scheduled Banks only, and the non-scheduled banks are outside the scope of its action As far as the Scheduled Banks are concerned the Reserve Bank offers certain facilities These facilities are

in regard to "Discounts and Advances" The provisions relating to granting Discounts and Advance facilities are as follows

The Bank is authorised to purchase, sell and rediscount —

(1) Bills of Exchange and Promissory notes drawn on, and payable in, India and arising out of **bonafide** commercial or trade transactions bearing two or more good signatures one of which must be that of a Scheduled Bank and maturing within 90 days, from the date of such purchase, sale or rediscount exclusive of days of grace

(2) Bills of Exchange and Promissory notes drawn and payable in India bearing two or more good signatures, one of which must be that of a Scheduled Bank or a Provincial Co-operative Bank, and which are issued for financing seasonal agricultural operations or the marketing of crops, and maturing within nine months of the date of purchase, sale or rediscount

(3) Bills and Promissory notes drawn and payable in India for holding or trading in Government Securities bearing the signature of a Scheduled Bank and maturing within 90 days

(4) Bills of exchange, including treasury bills, drawn in any place in the U K maturing within 90 days, provided that no such sale, purchase or rediscount is made in India, except within a Scheduled Bank

The Bank is authorised to grant loans and advances to Scheduled Banks repayable on demand or on the expiry of fixed periods not exceeding 90 days on the security of —

(a) Stocks funds and Securities in which a Trustee is authorised to invest trust funds,

(b) gold, silver or documents of title thereto,

(c) bills of exchange or promissory notes as are eligible for purchase or rediscount by the Reserve Bank,

(d) promissory notes of any Scheduled Bank or any Provincial Co-operative Bank supported by documents of title to goods which have been transferred to or pledged to the Bank as security for a cash credit granted for **bonafide** commercial transactions or for the purpose of financing seasonal agricultural operations or for the marketing of crops

The policy which the Reserve Bank follows in discounting for, and making advances to, Scheduled Banks is laid down in a memorandum issued by it in 1938 In extending credit facilities, the Reserve Bank takes into consideration not only the nature of the security offered to it but also the general character of the investments of the applying Bank and the manner in which its business as a whole is being conducted. In regard to agricultural credit, as the Reserve Bank cannot advance directly to agriculturists, it can extend credit facilities only through Scheduled or Co-operative Banks

Its discounts and advances are of a two-fold character First, the Bank can advance only for short periods on strictly banking principles, and, secondly, it cannot supply long-term credit to agriculturists as it can deal with bills of nine months' duration only

It must, however, be clearly understood that the Reserve Bank is not bound to re-discount eligible bills and Scheduled Banks cannot claim it as a matter of right

Though the Reserve Bank has relations with the Scheduled Banks only, it keeps in touch with non-scheduled Banks as well, inasmuch as these Banks are likely to become Scheduled Banks when the capital and reserves of the non-scheduled Banks reach the figure of Rs 5 lakhs In order, therefore, to keep in touch with these Banks, the Reserve Bank requested the Central Government to amend the Indian Companies Act making it obligatory on these Banks to send three copies of their returns to the Registrars of Companies and Firms, so that the latter may send one copy to the Reserve Bank In practice, the non-scheduled Banks have been sending returns accordingly, though the number of such Banks sending returns has declined in recent years* Further, the Reserve Bank offers advice to such of those as seek it It also offers remittance facilities†

(c) A Banker to Government:

In addition to the function of note issue and acting as a Bankers' Bank, the Reserve Bank of India also acts as a Banker to Central and Provincial Governments As a Banker to the Central Govern-

* The number of non-scheduled Banks submitting cash reserve returns under Sec 277(L) of the Indian Companies Act (as amended in 1938) dwindled from 669 in 1939 to 530 in 1943 and thereafter improved to 613 in 1944

† See Appendix III.

ment, it is obliged to keep moneys for account to the Secretary of State, the Central Government and the Provincial Governments and approved States and to make payments, upto the amounts standing to the credit of their accounts, respectively, and to carry out their exchange remittance and other banking operations, and the management of the public debt The Bank has entered into separate agreements with the Central and the Provincial Governments setting out the terms on which it will transact their business Under the terms, it has to transact the business of the Central Government without remuneration and for floating the treasury bills it is entitled to receive commission at Rs 2,000 per one lakh of rupees

Provincial Governments started opening their accounts with the Reserve Bank of India after 1937 They are maintaining a minimum balance in cash with the Bank as per their agreements

Both the Central and the Provincial Governments obtain funds by resorting to ways and means advances to meet temporary deficits or by the issue of treasury bills Some Provincial Govenments have floated loans through the Reserve Bank which has acted as the agent for several Provincial Governments for the purpose

(d) Exchange obligations:

As the Central Bank of the country, the Reserve Bank is entrusted with the duty of maintaining the external stability of the rupee For this purpose it is required to buy and sell sterling within certain limits fixed by the Act The Bank is obliged to sell on demand Sterling for immediate delivery at London at a rate not below 1 sh 5-6/49d Similarly, the Bank is under an obligation to buy sterling at a rate not higher than 1 sh 6-1/3d * In either case the amount bought

* By an amendment to the Reserve Bank of India Act passed on 8-4-1947 (Secs 41 and 42) the statutory relations between the rupee and the sterling has been broken It was also the result of India's participation in the International Monetary Fund and her declaration of the par value of the rupee at one rupee=8 47532 (gold) But India continues to have the link with sterling or is in the sterling area still, till the question of Sterling Balances are settled Consequent on India's membership of the Fund and the fixing of the par value of the rupee, sections 40 and 41 of the Reserve Bank of India Act, under which the Bank was obliged to buy and sell sterling without limit at specified rates, were repealed by the Central Assembly in April 1947 and replaced by a new section which requires the Bank to buy and sell foreign exchange at such rates and on such terms as the Central Government may determine from time to time in conformity with its obligations as a member of the fund

or sold should not be less than £10,000 As already referred to, the Bank is under an obligation to meet the exchange requirements of the Government For this purpose it purchases sterling by means of weekly tender. The method of purchase of sterling in London affords the Bank a convenient method of transferring its funds to India during the busy season when there is usually a keen demand for remittance to this country, it, incidentally, tends to relieve the seasonal stringency in the Indian money market

(B) OTHER FUNCTIONS

In addition to the above Central Banking functions, the Reserve Bank performs a number of other functions besides, such as the extension of remittance facilities, clearing, supply of currency and coin, etc

The Reserve Bank is responsible for maintaining at Government Treasuries and Sub-treasuries, as well as at its offices, branches, and agencies, sufficient stocks of notes and coins for meeting the requirements of the Government as also for providing reasonable remittance facilities to the public. For this purpose, all branches of the Imperial Bank and Government treasuries and Sub-treasuries in India having currency chest facilities, numbering about 1300 (including Burma) are regarded as agencies of the Reserve Bank and are required to extend facilities to the Banks and the public at rates specified by the Reserve Bank with the approval of the Central and the Provincial Governments.

The Reserve Bank manages clearing houses in principal cities like Bombay, Delhi, Madras, and Lahore on behalf of clearing Banks established in each place

The Reserve Bank is required to convert notes of five rupees or upward into notes of lower value or other legal tender, in such quantities as, in its own opinion, are required for circulation The Bank is obliged to issue rupee coin on demand in exchange for coin or notes

Other Banking functions:

The Reserve Bank is authorised to transact the following business

(1) Keeping of balances with Banks in the U K (2) the issue of demand drafts payable at its own office or agencies (3) purchase or sale of Government securities of the United Kingdom maturing within ten years (4) pur-

chase and sale of securities of an Indian State or a local body, as may be specified by the Government of India, but the total value of such securities should not be more than 3/5ths of the liabilities of the Banking Department, in the case of securities maturing after one year, its total value should not be more than 2/5ths of the liabilities of the Banking Department, and, in the case of securities maturing after 10 years, the total value should not be more than 1/5th of the liabilities of the Banking Department (5) The custody of moneys, securities, and other articles of value, and the collection of proceeds, whether principal, interest or dividend, of any such shares (6) It is also authorised to purchase and sell gold

Reserve Bank and Agricultural Credit

The Reserve Bank maintains an agricultural credit department to study all questions of agricultural trade and co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the Provincial Co-operative Banks and any other Banks, Organisations engaged in the business of agricultural credit In making provision for the maintenance of this department, the Act may be stated to have followed the example of a similar provision in the Commonwealth Bank of Australia Act

The Reserve Bank of India is authorised to grant rediscount facilities and grant loans to Provincial Co-operative Banks in discharge of its function of granting agricultural credit As the Central Bank of the country, the Reserve Bank cannot lend to agriculturists direct or advance large sums to Co-operative Banks or indigenous bankers for being lent out to cultivators as a matter of course What the Reserve Bank is authorised to do by the Act is to re-discount agricultural bills resulting from agricultural operations or the marketing of crops and maturing within nine months and endorsed by a Scheduled Bank or a Provincial Co-operative Bank In other words, the Reserve Bank is authorised to rediscount agricultural bills already discounted by a Scheduled Bank or a Provincial Co-operative Bank The Reserve Bank rediscounts such bills for Scheduled Banks and Co-operative Banks as per terms and conditions laid down in its Memorandum of 1938 Further, the financial accommodation which the Reserve Bank is authorised to give covers the following cases

(a) Loans or advances against Government paper for ninety days to Provincial Co-operative Banks and

Central Land Mortgage Banks declared to be Provincial Co-operative Banks and, through them, to Co-operative Central Banks and Primary Land Mortgage Banks

(b) Similar loans and advances to Provincial Co-operative Banks and Central Land Mortgage Banks declared to be Provincial Co-operative Banks and, through them, to the Co-operative Central Banks and Primary Land Mortgage Banks against approved debentures of recognised Land Mortgage Banks which are declared trustee securities* and which are readily marketable.

(c) Advances to Provincial Co-operative Banks for ninety days against promissory notes of Central Co-operative Banks and drawn for financing seasonal agricultural operations, or rediscount of such promissory notes maturing within nine months

(d) Loans and advances not exceeding ninety days to Provincial Co-operative Banks against promissory notes of approved co-operative marketing or warehousing societies endorsed by Provincial Co-operative Banks and drawn for the marketing of crops, or rediscount of such promissory notes maturing within nine months, or loans and advances on the promissory notes of Provincial Cooperative Banks supported by warehouse receipts or pledge of goods against which a cash credit or overdraft has been granted by the Provincial Co-operative Bank to marketing or warehouse societies

But the Co-operative Banks desirous of getting financial accommodation from the Reserve Bank should fulfil certain conditions which have been laid down in its Memorandum of 1938 One of the conditions is that a Provincial Co-operative Bank should maintain with the Bank cash balances the amount of which should not, at the close of business on any day, be less than 2½ per cent of the demand liabilities and 1 per cent of the time liabilities of such a bank in India and that it should submit to the bank periodical statements prescribed for the purpose

The benefit to the agriculturists of the credit facilities of the Reserve Bank is, therefore, largely dependent on the extent to which Scheduled Banks and Co-operative Banks are themselves interested in financing the agricul-

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* See page 35.

tural needs, for it is to those institutions that credit facilities are given with the hope that they will extend them further to the cultivators Unless the co-operative movement plays an adequate part, the credit facilities offered to it by the Reserve Bank in the matter of rediscounts and loans, rarely reach the producers The Reserve Bank has made efforts recently to assist the Provincial Co-operative Banks by offering a rebate of 1 per cent on the bank rate in regard to advances made by it Yet few Provincial Co-operative Banks have taken advantage of the offer, partly because they have enough funds for themselves partly because the Reserve Bank cannot lend for more than nine months, and partly because some Provincial Banks express themselves as unable to work under the restrictions imposed by the Reserve Bank [1]

The Reserve Bank and the Indigenous Bankers:†

Section 55(1)(a) of the Reserve Bank of India Act required the Bank to make a report to the Central Government, before 31st December, 1937, "on the extension of the provisions of the Act relating to Scheduled Banks to persons and firms, not being Scheduled Banks, engaged in British India in the business of Banking" The persons and firms referred to in this section are usually known as the "Indigenous bankers" Accordingly, the Reserve Bank addressed a circular letter on 6th May, 1937, to all Scheduled Banks and indigenous bankers with a view to eliciting their opinion on the possibilities of linking the indigenous banker with the Reserve Bank Very briefly, the Bank suggested that, if the indigenous bankers were to come into practical relationship with the Bank, they would be required to formalise their methods of business on lines approximating to joint-stock banks and, in particular, develop the deposit side of banking activities In the light of the replies received, the Bank formulated its draft scheme dated 26th August, 1937 for the direct linking of indigenous banks with the Reserve Bank based on the recommendations of the Central Banking Enquiry Committee The conditions laid down by the Reserve Bank were as follows,

1 W R Sattianathan, and J C Ryan, *Co-operation*, page 13

† Statutory Report of the Agricultural Credit Department, Reserve Bank

(1) They must confine their business to banking as defined by the Indian Companies Act.* Any other business they might be conducting should be wound up within a reasonable time.

(2) They must maintain proper books of account and have them audited by registered accountants, the Reserve Bank will have the right to inspect the accounts and call for any information necessary to determine the financial status of a banker.

(3) They must file with the Reserve Bank periodical statements prescribed for Scheduled Banks They must also, in the interest of their depositors, publish the returns prescribed for banking companies by the Companies Act and be liable to the same penalties for non-compliance

(4) The Reserve Bank will have the right of regulating the business of the bankers on banking lines if and when necessary

(5) During a period of five years from the date of their registration as private bankers in the books of the Reserve Bank, they will be entitled to open an account at any of the offices of the Reserve Bank, and be otherwise subject to the same conditions as the Scheduled Banks, except that, during such period, they will not be required to furnish the compulsory deposits set out in section 42 of the Reserve Bank Act, unless any of their weekly statements discloses that their time and demand liabilities are five times or more in excess of their capital in the business

(6) If an indigenous banker does not incoroprate himself under the Companies Act, his liabilities in respect of his banking commitments will be unlimited He should, therefore, state the amount of capital he has available for banking business (Bankers with a capital of less than two lakhs need not apply)

(7) When required, they will have to indicate
   (a) the names and the extent of interest of their business partner, if any, and
   (b) if any of the bankers is a member of a Hindu Joint family, the names and interests of the

* See page 105 for definition of a Banking Company as per Indian Companies Act.

co-sharers In both the cases, statements will be required from the co-sharers that they are prepared to take their full share in the business and its liabilities

(8) This scheme will be a tentative one for a term of five years, but, before the end of this period, the Reserve Bank will frame proposals for legislation, if it thinks fit, further to co-ordinate or regulate the position of the private banker It is likely that such legislation would take the form of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standardise and co-ordinate the status of these registered private bankers on lines in consonance with the Scheduled Banks

(9) (1) If they satisfy the above conditions, they will have the privilege of rediscount with the Reserve Bank against eligible paper, the right to secure advances against Government paper, and remittance facilities similar to those for the Scheduled Banks

(2) If the Reserve Bank decides to take action on the lines here indicated, legislation will be necessary, and the indigenous bankers will then be called upon to make an application in the manner which may then be prescribed

Since the representatives of the Indigenous Bankers and Shroffs' Associations were not agreeable to these conditions, the Reserve Bank, in a communication to the Central Government, explained the reasons why it has not yet been found possible to recommend legislation for extending to indigenous bankers the provisions of the Reserve Bank Act relating to Scheduled Banks

The Reserve Bank in Action:

The Reserve Bank, which started functioning on 1st April 1935, has been performing most of its functions satisfactorily The presence of the Reserve Bank in the banking system has a salutary effect and has brought down the interest rates The peculiar agricultural character of the country demands adequate supplies of money (cash) during the busy season and its absence in the slack season, a factor which the Central Banking authority has to take into consideration in formulating its monetary policy Before the Reserve Bank was established the Imperial Bank was given loans upto Rs 12 crores from the

paper currency reserves to meet the demands for supplies of money in the busy season The fact that, despite this, the Imperial Bank almost failed where the Reserve Bank has since succeeded is in itself a justification for the existence of the latter It is true that it was dual control which existed that prevented the effective infusion of money when needed in the busy season, and it is precisely because the Reserve Bank combines and has control over both currency and credit it has succeeded Whatever may be the case the fact remains that the Reserve Bank has been able to follow a policy of cheap money and bridge the gulf in demands for money between the busy and the slack seasons It has also maintained the Bank rate at 3 per cent One has, however, to remember here that, ever since the Reserve Bank was established, easy money conditions have prevailed

Reserve Bank and Control of Credit:

As is provided in the preamble to the Reserve Bank of India Act, the function of the Bank is control currency and credit to its advantage The control that a Central Bank is able to exercise on the monetary system largely depends upon the control that it is able to exercise on the constituents of the purchasing power In all countries, not excluding India, token coins and currency notes form the bulk of the purchasing power, the latter being more important than the former In countries where banking has developed, the deposit currency plays not an inconsiderable part In this case, payments are made and received more by means of cheques than by means of actual cash and currency notes In recent years, in India, the currency notes and the bank deposits form the bulk of the purchasing power, insofar as they are used to a greater extent for making and receiving payments* The Reserve Bank has been given the monopoly of note issue to enable it to exercise control over the volume of bank notes.

* The relative importance of deposit currency and notes can be seen from the following figures

(Figures in Crores)

Year	Demand deposits	Clearing House returns	Notes issued	Notes in circulation
	Rs		Rs	Rs
1935-36	123	1843	192	164
1938-39	129	1974	203	174
1941-42	211	2684	299	287
1944-45	585	5279	979	968

Under the present reserve arrangements, the backing for notes is a certain percentage of gold or sterling securities and rupee securities But the notes are not convertible into gold Even the stocks of rupee coins are inadequate to meet the demand for conversion of notes into coins The gold reserves are protected by making availability to the public only in quantities of 400 oz, at a time Therefore, the issue of notes is not regulated with a view to encashment of notes, either in terms of rupees or in terms of gold The Sterling Securities which constitute a portion of the reserves are useful for meeting the external obligations, though, on its basis, the volume of money could be expanded by issuing notes But the increase in Sterling Securities need not generally follow with an expansion in the number of notes,* though as historical accident the increase in the sterling assets has been used during the war as a means of expanding the volume of bank notes** Ordinarily, the expansion or contraction of currency is brought out under section 33(1) by increasing the assets of the issue department As the assets of the issue department, excluding the Sterling Securities, are not much, it has limited significance***

Coming to the question of control over deposit currency, it can be said that a well-knit organised banking system is a necessity if the Central Bank has to control effectively the deposit currency In the first place, the

* Rotary Address of Sir (then Mr) C D Deshmukh, Governor of the Reserve Bank, 31st August 1943

** C N. Vakil, *Our Sterling Balances*, pages 29-30

*** The Reserve Bank of India expands the volume of currency as follows —

Under Sec 33(1) of the Reserve Bank of India Act, the assets of the Issue Department are held in form of (*a*) rupee coin including rupee notes (*b*) gold coin and gold bullion (*c*) rupee securities, including treasury bills and sterling securities

Expansion of currency can be effected by increasing any of these forms of assets and issuing equivalent notes from the Issue Department Similarly contraction can be effected by withdrawing notes from circulation and reducing any of the assets Ordinarily, in the case of expansion, the Bank increases the assets of the Issue Department by transferring rupee or sterling securities or both from the Banking to the Issue Department or by cancellation of *ad hoc* treasury bills, and in the case of contraction reduces the assets by transferring securities, rupee or sterling or both from the Issue to the Banking department or by cancellaton of *ad hoc* treasury bills held in the Issue Department Sometimes, currency is expanded or contracted on account of revaluation of securities held in the Issue Department

Central Bank of a country must have direct relationship with all the banking institutions operating in the country. Sometimes not all the banks operating in a country may have direct relations with the Central Bank, such as keeping deposits with the Central Bank voluntarily or in the form of minimum reserves prescribed by law and rediscounting with the Central Bank, whenever their available funds are insufficient for their business [1] In our country, neither the Non-Scheduled Banks nor the indigenous bankers have any direct relations with the Reserve Bank and consequently they are outside the radius of action of the Reserve Bank Secondly, even in the case of Scheduled Banks the rigid percentage of 5 per cent and 2 per cent respectively of the demand and time liabilities which the Scheduled Banks are to keep with the Reserve Bank hardly enables the latter to control the Bank credit that may be expanded by these banks on the basis of the till money left with them, after making the above deposits Even in times when the Banks' deposits swell beyond all proportions, the Banks deposit with the Reserve Bank only 5 per cent. and 3 per cent. respectively, of their time and demand liabilities From out of what remains after allowing for deposits as above and the cash required for meeting the demands of depositors at a certain ratio the banks can expand the volume of Bank credit without the knowledge of the Reserve Bank, the latter will come to know of it only when there is demand for cash against the expanded Bank credit or when credit is translated into currency notes which are likely to be depleted. In these circumstances, the Bank can hardly have any effective control over the expansion of Bank credit The Reserve Bank would be in a better position to influence the credit expansion policy by the Banks if it took power to change the percentage of time and demand liabilities and to insist on such being deposited as and when circumstances might warrant For example, when the deposits of the Banks increase, the Reserve Bank can insist on the Scheduled Banks depositing a higher percentage of demand and time deposits and, at times when the Banks' deposits are depleted, the Banks may be asked to deposit a lower percentage It will also be necessary for the Reserve Bank to create another classification for those Banks having capital and reserves between Rs 1 lakh and Rs 5 lakhs, so as to be enabled

(1) De Kock, *Central Banking*, page 323.

to ask them to deposit a smaller percentage of their demand and time liabilities India is a country of small banks and it bids fair to be so for a number of years to come and, therefore, it will be necessary for the Reserve Bank to control and influence the credit policies of these banks *

The Reserve Bank and the Money Market:

The influence and control of a Central Bank on the money market depends upon various factors In the first place, the Central Bank of a country must have direct relations with all the banks operating in the country As pointed out above, neither the Non-Scheduled Banks nor the indigenous bankers have any direct relations with the Reserve Bank, and this imposes a severe limitation on the power of the latter in controlling the credit policy of these institutions In the second place, it all depends to what extent the money market is accustomed to rely on its own funds and on those borrowed from Banks Thirdly, the extent to which the Banks need financial accommodation by way of rediscounts and loans from the Central Bank determines the influence of the Central Bank.

Insofar as the dependence of the money market on the Reserve Bank as a lender of the last resort is concerned, it appears that Commercial Banks and indigenous bankers are not dependent upon it The volume of Commercial bills and hundis is not much ** Credit is made available to the market from their own resources The Commercial Banks have their own re-

* While the time deposits of Scheduled Banks have not showed an increase with the increase in demand deposits, in the case of Non-Scheduled Banks, time deposits have increased equally with demand deposits, showing thereby that individual deposits are more in smaller banks, while in the bigger banks deposits are mostly of business concerns See pages 98-99

**The following figures show the Bills discounted by the Reserve Bank of India and the Commercial Banks —

(In Crores of Rupees)

	Reserve Bank of India	Commercial Banks
1938-39	1 38	4 86
1939-40	2 87	5 25
1940-41	97	3 84
1941-42	27	4 93
1942-43	68	2 18
1943-44	91	2 18

sources and, therefore, they are not dependent on the Reserve Bank for the creation of credit Further, smaller banks obtain accommodation from bigger commercial banks Such inter-bank lending has also tended to weaken the control of the Reserve Bank over the money market [1] It is true that, when bigger banks find their resources replete or inadequate, they call back the loans they have made or approach the Reserve Bank for financial assistance However, the creation of the Reserve Bank has coincided with the period of easy money conditions The time to assess the role of the Reserve Bank in relation to the money market is therefore hardly opportune

Like all Central Banks, the Reserve Bank has two weapons in the form of (1) Bank rate and (2) open market operations policy The Bank rate is the rate at which the Reserve Bank grants loans on the basis of Government securities to Commercial Banks It is also the rate at which it undertakes to re-discount first class bills approved by it for the later The extent to which the Bank can make its bank rate felt depends upon the extent to which banks depend on re-discount facilities If the banks refuse to borrow or re-discount the bills, it will not be effective Even in countries with highly organised banking institutions, the Central Banks may find it difficult to make the bank rate effective if the Banks do not co-operate In India, dependence of the Banks on the Reserve Bank for financial accommodation is not much, as, at present, easy money conditions are prevalent Even in ordinary times, the crux of the question in India is to make the bank rate effective in all places, because different rates prevail in different places A uniform bank rate applicable to all markets in India is conspicuous by its absence, in some places, the same bank rate may be high and, in some places, it may be low

Among other methods by which the Reserve Bank can, to some extent, control the monetary and banking systems, mention may be made of appropriate changes in the amount of treasury bills offered, in the amount of sterling purchased, and in the amount of money in circulation, but these methods are comparatively less effective and of limited applicability Thus, although the Reserve Bank has been entrusted with most of the powers generally given to a Central Bank, its actual control is limited by

(1) S G Panandikar, *Banking in India*, page 339.

the peculiar character of the Indian monetary and banking system

The Reserve Bank has the power to resort to open market operations if it thinks that conditions warrant their application Central Banks resort to open market operations, inter alia, to make the Bank rate effective, though the Bank rate operates in the main, to regulate short-term money market Open market operations may be defined as those operations which are undertaken by a Central Bank on its own initiative in order to affect the volume of short-term funds (Central Bank credit) in the country by dealing directly in the market instead of using its influence only indirectly, as, for example, by altering the price of supply [1] Section 18 of the Reserve Bank of India Act authorises the Bank in circumstances, when, in its opinion, it is necessary or expedient that action should be taken for the purpose of regulating credit in the interests of Indian trade, commerce, industry or agriculture, the Bank may

(1) Purchase, sell, or discount any of the bills of exchange and promissory notes which it is authorised to re-discount to Scheduled Banks and Co-operative Banks only in ordinary circumstances, even though such bill or promissory note does not bear the signature of a Scheduled Bank or a Provincial Co-operative Bank, or

(2) purchase or sell sterling in amounts of not less than the equivalent of one lakh of rupees, or

(3) make loans or advances repayable on demand or on expiry of fixed periods not exceeding ninety days against the various forms of security as required by that section (Sec 17 Clause 4)

The success of these operations depends upon two factors, viz, the resources the Central Bank has at its disposal, and, secondly, the capacity and the responsiveness of the market in which they are sought to be carried out The resources of the Reserve Bank, consisting of capital and reserves, the floating deposits of Scheduled Banks, and the Government are considered inadequate for the purpose The market also is considered to be limited It is as yet too early, however, to pronounce any judgement on this point

(1) A Ramaiya, *The Reserve Bank of India Act*, Appendix, page 160

STATEMENT OF AFFAIRS OF THE RESERVE BANK OF INDIA.

Issue Department.

Liabilities.	Assets.
Notes issued.	A.—Gold coin and Bullion.
In Banking Department.	(*a*) Held in India
In circulation.	(*b*) Held outside India.
	Sterling Securities.
	Total of A
	B.—Rupee Coin
	Government of India Rupee Securities
	Internal bills of Exchange and other Commercial papers.
Total	Total

Ratio of Gold and Sterling Securities (A) to Note issued

Banking Department

Liabilities.	Assets
Capital paid up	Notes
Reserve Fund	Rupee Coin
Deposits.	Subsidiary Coin
(*a*) Government.	Bills Discounted
(1) Central Govt of India.	(*a*) Internal
(2) Govt of Burma	(*b*) External
(3) Other Govt Accounts.	(*b*) Govt of India Treasury bills.
	Balances held abroad
	Loans and Advances to Government.
(*b*) Banks.	Other Loans and advances
(*c*) Others	Investments
Bills payable	Other assets
Other liabilities.	
Total	Total

CHAPTER XII

MONEY, BILL, AND CAPITAL MARKETS

A money market is a market for the borrowing and lending of short-term funds On the borrowing side, there are the trade and industry and, on the lending side, there are the investing institutions like the Commercial Banks, Discount Houses, Bill Brokers, and, finally, the Central Bank as the lender of the last resort. A money market usually deals in trade bills, promissory notes, and Government paper The loans are made for short periods at low rates of interest and the investing institutions consider this kind of investment as liquid It is liquid, in the sense that cash could be realised at short notice, inasmuch as they are readily marketable and also because they can be sold without loss of money.

A Central Bank influences the short-term money market by means of its Bank rate Sometimes it resorts to open market operations to support the Bank rate policy and to make the Bank rate effective However, the success of Central Bank to influence the money market depends upon whether the money market is organised or unorganised, and also on the connection the various constituents have with each other as well as with the Central Bank, and, above all, on how far the money market itself is dependent on the Central Bank for financial accommodation

Indian Money Market· Its constituents and peculiarities:

The principal constituents of the Indian Money Market are the indigenous bankers, the Commercial banks, the Imperial Bank of India, the Exchange Banks, and the Reserve Bank of India In addition to the indigenous bankers, there are the **Nidhis**, chitfunds, and loan offices of Bengal These constitute what is generally called the indigenous money market as distinguished from the commercial banks, the Imperial Bank of India, the Exchange Banks, which are termed as constituting what is known as the "Central Money Market" Sometimes, it is called the European money market, which is anomalous at any rate in a Free India

The first peculiarity of the Indian Money Market is the division into two parts, the bazaar part and the Central part as above The constituents of the "Central Money Market" had no connection with each other by Statute before the Reserve Bank was established However, the

Imperial Bank of India was a common link, in that both the Exchange Banks and the Commercial Banks had dealings with it Even the indigenous bankers had accounts with the Imperial Bank Though the Imperial Bank acted as a sort of a Bankers' Bank, the Indian banks did not hesitate to consider it as their rival The Exchange Banks were a group by themselves and the Indian banks and businessmen often complained against them The result was that the money market was a loose structure And this could be described as the second feature of the Indian Money Market

Before the Reserve Bank of India was established, there was no effective co-ordination between currency and credit, so necessary for influencing the volume of money, if the supply of money is to be co-ordinated to the demand The reason was that currency was controlled by the Government, and the Imperial Bank, to some extent, influenced the credit

Even the indigenous part of the money market is not homogeneous It is divided into **Marwari, Multani** and **Gujerati** bazaars with different business practices and different money rates The Indigenous bankers generally depend upon their own resources and it is only in the busy season that they generally seek the financial facilities from the Imperial Bank of India and other Commercial Banks for discounting their **hundis**

This explains the "confusion and chaos" in the rates of the money market The Central Banking Enquiry Committee, commenting upon this observed, "The fact that a call money rate of $\frac{3}{4}$ per cent, a **hundi** rate of 3 per cent, a bank rate of 4 per cent, a Bombay Bazaar rate for bills of small traders of $6\frac{3}{4}$ per cent and a Calcutta Bazaar rate for bills of small traders of 10 per cent can exist simultaneously indicates the extraordinary sluggishness in the movement of credit between the various markets" The following figures are further illustrative of the same feature

Year	Bank rate	Imperial Bank Hundi rate	Bazar Rate Bombay	Bazar Rate Calcutta	Call Money rate Bombay	Call Money rate Calcutta
1925—						
April	7	7	$11\frac{1}{4}$	$10\frac{1}{2}$ to 11	$6\frac{1}{2}$	5
October	5	5	9 3/8	10 to 11	1	$1\frac{3}{4}$
1928—						
April	7	7	$9\frac{3}{4}$	10 to 11	$5\frac{1}{2}$-$5\frac{3}{4}$	$6\frac{1}{2}$
October	5	5	$6\frac{3}{4}$	9 to 10	2 -$2\frac{1}{4}$	$2\frac{1}{4}$

Another peculiar characteristic of the Indian Money Market is the prevalence of monetary stringency and high rates during the busy season extending from November to June In this period, due to the movement of crops and raw materials from the interior to the Port towns and other distribution centres, the demand for money is felt and hence the rise in money rates Before the Reserve Bank was established, the Imperial Bank of India assisted the money market in the busy season by discounting hundis. To enable the Imperial Bank to do so, the Paper Currency Act provided for the grant of a loan to the Imperial Bank upto Rs 12 crores against Inland bills of Exchange With the increased cash of Government money in its vaults the Imperial Bank was able to assist the market by its discounts and loans policy Still it was of no avail The monetary stringency was attributed partly to the dual control of currency and credit and partly to the Government borrowing The following figures are illustrative of the wide range of fluctuation in the money rates

	Bank Rate	
	Highest	Lowest
1924	9	4
1928	7	5
1933-34	3½	3½

With the establishment of the Reserve Bank of India, the Bank has followed a cheap money policy by keeping the Bank rate throughout at 3 per cent This has, to some extent, influenced the downward tendency in the money rates

The Bank rate and its significance to the Money Market

A Bank rate has great significance to the money market and varies with the intensity of the demand for, and the supply of, money The Imperial Bank rate varied inversely with the Government cash balances which got depleted with the busy season and began to swell in the slack season [1] What was most striking was that, in the busy season the funds were not enough for the movement of crops and goods and, in the slack season, the money could not fetch any rate of interest, unless the Government

(1) G B Jathar, and S G. Beri, *Indian Economics*, Vol 2, page 392

operated the treasury bills and created scarce money conditions.

Call Money rate:

The call money rate is the rate for surplus money seeking investment for possible a minimum period of 24 hours As distinguished from the call money rate, the Bank rate indicates the charge for the use of money for a specified period. While call money is repayable at the option of either the borrower or the lender, the loans on the basis of Government securities are repayable at the option of the borrower only Therefore, the Bank rate ought to be higher than the call money rate, as the rates for day-to-day loans are less than rates for those which are for a specified period In India, call money was sometimes unlendable at any rate in the slack season and it was unobtainable in the busy season even at or reasonably the bank rate. With the establishment of the Reserve Bank of India, relatively easy money conditions may be stated to have come to stay

II

There is no bill market in India It is not that bills are unknown to the people of this country. In fact, the use of bills or **hundis** were known to the people of India from very early times "The safety of **Hundis** for travellers, as compared with the risk of carrying cash, must in itself have provided a good reason for the development of the **hundi** habit"

Before the establishment of the Reserve Bank of India, the Imperial Bank was discounting the **hundis** for banks and indigenous bankers However, the banks preferred loans and advances to the discounting of **hundis**, for the loans could be paid earlier The Imperial Bank had two rates, one the **hundi** rate, and the other the bank rate The former was the rate for discounting the **hundis** and the latter was the rate for lending money on the basis of Government Securities The Central Banking Enquiry Committee, examining the question observed that there were many difficulties in the way of the development of a bill market in India One was the the heavy stamp duties which, the Committee reccmmended, should be reduced Another was that business-men in India preferred cash credits to discounting bills The third was that there were bills of different character in different provinces There was no distinction between a finance bill or a trade bill

However, the Central Banking Enquiry Committee hoped that, with the establishment of the Reserve Bank, trade and commerce would increasingly be financed by the use of bills

Even after the establishment of the Reserve Bank of India, a bill market has not come into existence In the first place agricultural marketing, trade and commerce should be financed by means of bills Secondly, there must be special institutions for discounting these bills, like the Discount Houses There must also be bill brokers There must be acceptance houses In the absence of these institutions, no bill market can come into existence The indigenous bankers can conveniently convert themselves into acceptance houses

There are other factors besides which determine the successful working of a bill market A bill market can operate successfully if there is free sale of goods—the existence of orderly marketing When goods become sticky, and difficult to clear, bills become dangerous The Indian merchant or ryot, operating in an internal market congested with goods which do not meet a ready export sale, is a bad bank client [1] In fact, the demand for goods is not co-related to the supply by means of orderly marketing withholding when prices fall, selling when prices rise and this constitutes the major handicap

Even after the establishment of the Reserve Bank of India and the reduction of stamp duty on bills, a bill market has not come into existence Further, the Reserve Bank is authorised to rediscount eligible bills already discounted by the Scheduled Banks Still, of the 58 Scheduled Banks operating in India at the end of 1943, there were as many as 23 banks which did not hold any figure in the bills portfolio or held bills amounting to insignificant amounts Even Co-operative Banks are not taking advantage of the facilities offered by the Reserve Bank

III

Sometimes no distinction is made between the money market and the capital market, although it is so obvious in that, in the capital market, the investments are of a long-term character, while, in the money market, they are generally of a short-term character But they are inter-

(1) Letter from A P Macdougall to the Secretary, Central Banking Enquiry Committee—quoted in the Report under the heading "Marketing", page 723 (Enclosure XIV)

related, because the short-term rates influence the long-term rates Some authorities hold that changes in the long-term rate also bring about changes in the short-term market.

In the long-term or capital market, there are, on the lending side, the public, investing houses like insurance companies, trust associations, etc, and, on the borrowing side, there is the trade and industry The usual form is that the public or the investment houses subscribe to the shares or debentures In between these two, there are the share-brokers and underwriting houses The latter underwrite or agree to sell the shares of the companies on a commission basis and thus enable the company to collect its capital They generally undertake to procure capital for newly floated companies by means of underwriting the shares of such new companies. The share brokers not only underwrite shares, but they also act as intermediaries when the shares are sold from investor to investor They have as their main business to advise their clientele to purchase and sell shares, both of newly floated and of old companies In fact, short-term funds move from the money market to the share market and vice-versa, all depending on the yield of Government paper, the interest rates and the yield of industrial securities

Like the money market funds, funds to the capital market also come ultimately from national savings The annual national savings generally pass into various channels like the post office savings bank deposits, life insurance premia, investment in companies' shares and Government Loans

The funds invested in the Government Loans and the Post Office Savings Banks and cash certificates are hardly available to industry, and, to that extent, the Government borrowing acts as an active competitor to industry in the matter of getting capital It is true that, when the State increases its borrowing, it would reduce the incidence of taxation and thus afford relief to the existing industries. But, in any case, to the new industries, Government borrowing hardly helps

Exact figures are not available to show the amount of annual national savings According to one estimate, the known national savings increased between 1929 to 1938 by about Rs 210 crores, the annual savings being more than 23 crores The funds invested in companies increas-

ed only by 18 05 per cent [2] This figure also includes the funds of banking companies, and only a part of the funds of the banking institutions is available to industry. A still another estimate calculated for the period between 1913 and 1932 placed the annual national savings at Rs 75 crores [3] In recent years, the amount of annual national savings has increased enormously, as there are restrictions on investment in buildings, import of gold, etc Although it is doubtful whether the **per capita** national savings has increased, it can be safely assumed that the available national savings belong to those classes whose main business is investment And to this extent, it follows, funds are available for investment in industry

It is not enough to say that funds are available for investment in industry We have to examine the organisation through which these savings pass to industry In India, we have no investment houses, nor has the investor the benefit of a proficient and proper guide for making investment Apart from established commercial houses and industrial establishments owners who constitute the investing public, there are a large number of small investors besides a handful of investment trusts who would invest. It, however, takes a long time before the small investors come to have confidence in the industrial management, and once they do that, there would be no trouble for mobilising capital for industrial development

(2) P C Jain, *Industrial Problems of India*, page 215

(3) P S. Lokanathan, *Industrial Organisation in India*, page 138

CHAPTER XIII

BANK FAILURES AND BANKING LEGISLATION

As in other countries Banks have failed in India also. Modern banking in India is only sixty years old and during this period banking has developed considerably It is no wonder that during the same period a large number of banks have failed

An analysis of the causes of bank failures in India will not be without significance Such an analysis would enable those interested in banking, and the Government of the country to know the way the Indian banking has gone wrong and to legislate upon matters necessary Further, Banks are delicate institutions engaged in mobilising national savings to be diverted towards productive activities. Recent Monetary theorists have come to the conclusion that the failure of the banking system (commercial banks) to gauge the economic situation and adjust their credit policies that have led to economic and monetary crisis Therefore, not only in the narrow interest of protecting the shareholders and depositors, but also in the broader national interest banks need regulation In what manner and to what extent such regulation and control are necessary will be clear only by an analysis of the causes of bank failures The Bank failures are not peculiar to India Banks have failed in all countries The causes which have led to bank failures have differed from one country to another and in the same country the causes which brought about bank failures in one decade are not the same which have brought about such failures in another decade

The causes of Bank failures in India may be traced firstly to the structural defects and secondly to the general causes

Structural defects arise either because of the inadequate or the total absence of banking laws, in any country In the first place, when a bank is established under the provisions of Law, there should be laws governing its actual working These relate, for example, to the amount of paid up capital it should have before it could commence business Further the law should also state how its funds will have to be invested, how it should prepare its balance sheet, the rights and duties of directors, their financial in-

terest in the company, the amount of money that it should keep in its vaults or in account with other banks to meet an emergency

In the absence of such laws, banking companies were started in India with inadequate paid up capital Public deposits were invested in assets which could not be realised in times of difficulties, loans were given on inadequate or no security, and sometimes the banks' funds were used for speculative business The result was the same in all these cases in that each one of these led to the collapse of the bank concerned Examples are there in the history of Indian banking to show how banks failed due to inadequate paid up capital Of the total number of 86 banks, the failure of which was reported in 1939, as many as 30 banks had a paid up capital of less than Rs 5,000 Of these 30 banks as many as 3 banks had an authorised capital of Rs 1,00,000 and a paid up capital of less than Rs 2,000

There are instances where individual banks failed either because the directors misappropriated the funds, or the manager or the managing director invested funds in his own business or practised dishonesty, or because the bank invested its funds where such investment was unwarranted or worked on low cash ratios But these are but isolated instances Even these have arisen out of the fundamental lack of organisation arising out of the absence of legal obligation compelling them to conduct banking business in a particular manner consistent with public interest

This lack of legal obligation was visible in other countries also In Bulgaria there was no banking law till 1930 The Banking Law was passed in 1930 In other European countries too at this time (1930) either new laws were enacted or old laws amended and modified to suit the new economic set up created by the Great Depression

The absence of such watch over banking institutions, at any rate, till recently, and the absence of State policy to protect both the Banks and the depositors are perhaps factors which led to the establishment of unsound and uneconomic banks, only to fail after some years

The next structural defect which operated for bank failures has arisen out of a confusion and misunderstanding as to the real nature and functions of a commercial bank A Commercial Bank is generally expected to grant short-term credit or loans to agriculture, trade and industry When Commercial banks advance long-term credits to agriculture and industry, they place themselves in

a dangerous position. Though no commercial bank in India has financed long-term agricultural needs, some banks did furnish long-term capital to industrial concerns which led to their failure.

In addition to these structural defects there are some general causes which bring about bank failures in India. A factor militating against the success of banking in India is the general lack of confidence in banking institutions. People look upon banks with suspicion generally and it is up to the Banks and those interested in the promotion of banking as a national occupation to restore confidence in the minds of the public While Bank failures are associated with periods of economic crisis in Western countries, in India banks fail and collapse due to false and alarming rumours about the stability and standing of the banks spread by interested parties.

Generally in highly capitalist countries Banks fail because they are unable to get out of the crisis following a boom period Such was the case in regard to Banks in the European countries during and after the Great Depression. But in India Banks do not seem to fail on this account, for that would presuppose the existence of a well-knit banking system with an intimate relation with trading and commercial interests where the former would react to changes in trade and business conditions. Banks in India are for the most part moneylending institutions, barring a few prominent ones, doing such functions as granting loans on ornaments and jewels, a function really belonging to indigenous bankers or money lenders [1] This probably explains why Banks in India have not failed in groups or large numbers at a time, Bank failures are a matter of isolated instances

In recent years the failure of the Benares Bank and the Travancore National and Quilon Bank, particularly the latter, has awakened the Government as well as those interested in Banking, to the need for legislation for mitigating the hardship caused by such failures to depositors, if not to prevent such failures altogether The responsibility of the Reserve Bank of India as a Bankers' bank was the subject of considerable discussion when the Travancore National and Quilon Bank failed to meet its obligation to its depositors In fact the opinion was, and still is, that the Reserve Bank of India failed in its duty as a

(1) Report of Foreign Experts appended to the Report of the Central Banking Enquiry Committee (1931), page 625

Bankers' Bank by refusing assistance to this Bank prior to conducting an enquiry into its affairs The Travancore National and Quilon Bank was a Scheduled Bank and as such it kept its deposits with the Reserve Bank as was required of all Scheduled Banks and if only because of this, it is argued, there was no reason why the Reserve Bank, being as it was, in the know of things should have stiffened its attitude when the question of financial assistance arose The refusal of the Reserve Bank of India to grant aid when the Bank required it was perhaps due **inter alia** to the fact that the Reserve Bank wanted to caution other banks thereby that they too must keep their slates clean and not seek Reserve Bank's aid when in trouble, especially if brought about by their own mismanagement merely because the Reserve Bank happens to be a bankers' bank

The number of Banks which failed in 1914 was 43, involving paid up capital of Rs 35 1 lakhs The number of Banks which failed in 1943 was 50 involving, a paid up capital of Rs 6 3 lakhs The largest number of Banks failed in 1940, the number being 102 and the least number failed in 1920, the number in that year being 3 In all from 1913 to 1943, within a period of thirty years the total number of banks failed was 964, involving a paid up capital of Rs 963 2 lakhs

The following table shows the failures of Banks since 1914 —

(Figures in lakhs)

Year	No of Banks liquidated	Paid up Capital	Year	No of Banks liquidated	Paid up Capital
1914	43	109 1	1927	16	3 1
1915	11	4 6	1928	13	23 1
1916	13	4 2	1929	11	8 1
1917	9	25 2	1930	12	40 5
1918	7	1 4	1931	18	15 0
1919	4	4 0	1932	23	7 9
1920	3	7 2	1933	26	2 9
1921	7	1 2	1934	30	6 2
1922	15	3 2	1935	51	65 9
1923	20	465 4	1936	81	4 9
1924	18	11 3	1937	65	11 5
1925	17	18 7	1938	73	29.9
1926	14	3 9			

The following table shows the failure of Banks according to paid up capital.—

Year	Banks with less than Rs 5000 as paid up capital	Banks with paid up capital between Rs 5000 & Rs 10000	Banks with paid up capital between Rs 10000 & Rs 20000	Banks with paid up capital between Rs 20000 & Rs 30000	Banks with paid up capital between Rs 30000 & Rs 40000	Banks with paid up capital between Rs 40000 & Rs 50000	Banks with paid up capital between Rs 50000 & Rs 100000	Banks with paid up capital above Rs One Lakh	Banks with no details	Total
1939	30	15	8	5	7	3	6	2	10	86
1940	34	17	12	7	9	2	2		12	95
1941	19	11	9	5	3	3	2		6	58
1942	13	12	7	5	2	1	2	2	4	48
1943	16	6	6	1	8	2	4		12	50
1944	5	2	1	6			2	2	4	22
1945	9	3	1			1	3	1	6	24

Life of Banks with paid up capital of less than Rs 5,000

Year	Less than 5 years	More than 5 years but less than 10 years	Banks with more than 10 years but less than 15 years
1939	9	13	8

II

The need for regulating Banks in India was emphasised for the first time by the Central Banking Enquiry Committee in 1931, though the need for such regulation had been felt from very early years. The Committee analysed the causes which led to failures of a large number of Banks and came to the conclusion that such failures necessitated the enactment of a separate banking legislation The Foreign Experts associated with the Committee, however, were not in favour of a special Act, though they recommended that the Indian Companies Act should be amended suitably for the purpose

Accordingly, the provisions of the Indian Companies Act were amended in 1936 and additional provisions were included to meet the special requirements of Banking Companies Even these amendments were inadequate in certain respects. After the establishment of the Reserve Bank of India in 1935, and particularly after the Travancore National and Quilon Bank, Ltd, a Scheduled Bank,

had failed, the question of legislating adequately to regulate and control banking institutions assumed greater importance

In 1939, the Reserve Bank of India addressed a letter to the Government of India emphasizing the need for a comprehensive banking legislation in India The letter drew attention to the recent Bank failures and stressed the need for some sort of control to be exercised over them It also pointed out that, of the 1421 Non-Scheduled Banks, only 674 were submitting returns or maintaining cash balances as required by the Indian Companies Act, the rest claiming that they did not fall within the definition of banking companies, and their contention has been upheld by Courts Again, according to the Reserve Bank, the provisions of the Indian Companies Act were inadequate, in that they did not provide a deterrent to banks in difficulty, and it was in such cases that the interests of the depositors required to be specially protected Further, it was made out, Banks registered before the Indian Companies Amendment Act (1937) came into force continued to call themselves as such, though they did not conduct business as defined in the Act and refused to comply with the provisions of the Act The Reserve Bank's letter also drew attention to the poor capital structure of these banks, which was evident from the fact that, out of 1421 Non-Scheduled Banks, only 35 had capital and reserves between two and five lakhs of rupees The number of banks having capital and reserves between one and two lakhs of rupees was only 65, while 135 banks had capital and reserves between Rs 1 lakh and Rs 50,000

Finally, many of these banks worked on inadequate reserves, many employing most of their funds by loans and advances on inadequate security, their investments in Government securities were small, in most cases they were merely moneylending institutions The result was that, whenever an emergency arose, they had no second line of defence

The Banking Companies Bill (1945).—Following the above letter, the Government of India introduced a Banking Companies Bill in the Central Legislative Assembly in 1944 The Bill reached the Select Committee stage, but, before it could be taken up, the Central Legislative Assembly was dissolved and therefore the Bill lapsed

The Banking Companies Bill (1946)—A new Banking Companies Bill on the same lines as the one introduced

earlier was introduced in the Central Legislative Assembly in March, 1946 The Bill was referred to a Select Committee on 11th April, 1946, and the Select Committee made its report to the Assembly on 17th February, 1947. Even this Bill has been withdrawn following the statement of the Finance Minister in the Constituent Assembly (Legislative) on 30th January, 1948

Saliant features of the Banking Companies Bill (1946) as amended by the Select Committee:

In the first place, the Bill defined Banking clearly. Banking was defined as "the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise. The Bill also laid down that no Company other than a Banking Company shall accept deposits. Though the bill prohibited Banking Companies from engaging in trading activities they were permitted to do all legitimate business such as "clearing and forwarding of goods on behalf of customers and such other business as are essential for conducting banking business."*

Secondly the bill laid down certain capital standards for new banks as well as for existing banks if the latter had to open new branches. The Banking Companies (Restriction of Branches) Act passed in 1946 regulates to some extent the opening of branches by the established banks, in that the Act lays down that prior consent of the Reserve Bank of India is required for a bank to open a new branch office. However, the Bill of 1946 went further in many respects. The capital requirements of the Bill as amended by the Select Committee were as follows.

A Bank rgistered and having its principal place of business outside British India should have a capital and reserves of not less than Rs 15 lakhs, it must have an additional capital of Rs 5 lakhs if it has an office either at Bombay or Calcutta or at both places Banks registered

* It is interesting to note that in the Banking Bill of 1945 and in the original bill referred to above, banking had been defined as "the accepting of deposits repayable on demand " The Indian Companies Act as amended in 1936 defines a banking company as a company which carries on as its principal business the "accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order Both under the Indian Companies Act and the Banking Bills of 1945 and 1946, Banks are permitted to do other businesses which are incidental to banking business Further Sec. 277G of the Indian Companies Act restricts the business of a Company which adds to its name the word "bank", "banker", or "banking" to the business of accepting deposits of money on current account subject to withdrawal by cheque, draft or order

and having their principal offices of business in British India should have capital and reserves of not less than Rs 10 lakhs, if they have offices in more than one 'region', they should have an additional capital of Rs 5 lakhs if they have offices either at Bombay or Calcutta or in both the places Where a bank has all its offices in one 'region', not necessarily in one Province with no Office either at Bombay or Calcutta, it must have a capital and reserves of Rs 1 lakh, in addition it must have Rs 10,000 for each of the branch office established in the same district where the bank has its principal place of business, and Rs 20,000 for each of the branch office established outside the district but within the same province In any case such a bank need not be required to have more than Rs 5 lakhs* A Bank is required to have Rs 50,000 if it has a single office, if it opens another office it is required to have another Rs 50,000 Where a Bank has all its offices in one Province and has one or more offices at Bombay or Calcutta it must have a capital of Rs 5 lakhs, and Rs 25,000 in respect of each such office outside Bombay or Calcutta In any case such a bank need not have more than Rs 10 lakhs** It may be stated that the Banking Law of

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* An example would make the position clear A Bank registered in the Madras Province may be having 50 branches distributed as follows

Madras City (Head Office)	Rs 1 lakh
10 offices in the same district	Rs 1 lakh
40 offices outside the District but within the same Province	Rs 8 lakhs
	Rs 10 lakhs

However, such a Bank is required to have a minimum of Rs 5 lakhs

** This Bill before it was amended by the Select Committee and the Bill of 1945 defined the capital standards as follows —

No Company after the commencement of this Act shall commence or carry on business in British India unless it has a paid up capital and reserves of the aggregate value —

(1) of not less than Rs 20 lakhs if it has a place of business in India outside the Province in which it has its principal place of business or if it has its principal place of business elsewhere than in British India or in a case to which Clause (1) does not apply of not less than

(2) (a) five lakhs of rupees if it has any place of business at Bombay or Calcutta plus

(b) two lakhs of rupees in respect of each town (other than Bombay or Calcutta) having a population of over 1,00,000 in which it has any place of business plus

(c) Rupees 10,000 in respect of each other town, village or similar locality in which it has any place of business

Provided that in the case of a banking company to which only sub-clause (c) of clause (2) is applicable the minimum aggregate value of paid up capital and reserves for the purpose of this sub-section shall be Rs 1 lakh

Provided further that no banking company shall be required to have a paid-up capital and reserves exceeding an aggregate value of Rs 20 lakhs

Bulgaria enacted in 1932 also laid down capital standards for Joint-stock Banks.

Thirdly the Bill prohibited the employment of managing agents by banking companies, as also a person, who was engaged in any other business or vocation, or whose remuneration was in the form of share or profits in the concern or persons whose remuneration was disproportionate according to the normal standards prevailing in Banking business to the resources of the Company Whether the remuneration was disproportionate or not was to be decided by the Reserve Bank.*

Further a person who was a director of one bank was prohibited from becoming a director of another The Bill prohibited the making of unsecured loans to directors or firms or private companies in which the director was interested as a director, partner or managing agent Banks were also prohibited from holding the shares of Companies in which the director of the bank was interested as a manager or managing director. Where a bank had made unsecured loans to public companies in which the directors were interested, the bank was required to submit to the Reserve Bank monthly statements relating to such unsecured loans so that the Reserve Bank might scrutinise and issue instructions either imposing restrictions or banning such transactions altogether It may be stated that the Banking Law of **Chile** enacted in 1932 limited severely the amount of credit that might be granted by banks to directors and employees

The Bill prohibited a Banking Company from declaring dividends before it had written off its capitalised expenses Further every Banking Company, scheduled or non-scheduled, was required to set apart not less than 20 per cent of its profits to the Reserve Fund before dividends were declared till that Reserve Fund reached the figure of paid up capital ** Again, Banks were prohibited from making a charge on unpaid capital*** The Bill provided that every Banking Company, scheduled or non-scheduled, should maintain by way of reserves in cash with themselves or in an account opened with the Reserve Bank

* See Secs 277H & 277HH of the Indian Companies Act

** See Sec 277K (2) of the Indian Companies Act

*** See Sec 277J of the Indian Companies Act

2 per cent of the time and 5 per cent of the demand liabilities*

The bill provided for inspection of banks by the Reserve Bank either at the initiative of the Government or at their own initiative In any case, the bill provided, that the report made by the Reserve Bank of India should be made available to the bank concerned

The Bill further provided that the balance sheets of the banks should be prepared in the prescribed manner**

Under the provisions of the bill, all banks were required to take licence from the Reserve Bank of India. The existing Banks were allowed to take the licence within six months from the date of the commencement of the Act Further the provisions of the bill were made applicable to the Imperial Bank of India in matters not covered by the Imperial Bank of India Act The bill empowered the Reserve Bank to suspend the provisions of the bill for a period of 30 days, and Government of India, under the bill, was permitted to suspend its provisions for a period of one year

As said above, the bill was withdrawn with the permission of the Assembly on 30th January, 1948 A new bill was introduced in the Constituent Assembly (Legislative) on 22nd March, 1948

The Banking Companies Bill (1948)—The main features of the bill are as follows (1) a comprehensive definition of Banking so as to bring within the scope of the legislation all institutions which receive deposits, repayable on demand or otherwise for lending or investment, (2) prohibiting non-banking companies from accepting deposits repayable on demand, (3) prohibition of trading with a view to eliminating non-banking risks, (4) prescription of minimum capital standards, (5) limiting the payment of dividends, (6) inclusion in the scope of legislation of banks incorporated or registered outside the provinces of India, (7) introduction of a comprehensive system of licensing of banks and their branches, (8) prescription of a special form of balance sheet and conferring of powers on the Reserve Bank to call for periodical returns, (9)

* Sec 277L of the Indian Companies Act required of Non-Scheduled Banks to maintain cash reserves in cash, a sum equivalent to at least one and a half per cent of the time and 5 per cent of the demand liabilities This section does not apply to Scheduled Banks

** See Appendix IV

inspection of the books and accounts of a bank by the Reserve Bank, (10) empowering the Central Government to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors; (11) provision for bringing Reserve Bank of India into proposal touched with Banking Companies, (12) provision of an expeditious procedure for liquidation; (13) bringing the Imperial Bank of India within the perview of some of the provisions of the bill, (14) widening the powers of the Reserve Bank of India so as to enable it to come to the aid of banking companies in times of emergency, (15) provision for the extension of the Act to the acceding states

When the above bill is passed and becomes an Act India would be having a comprehensive banking legislation for the first time

APPENDIX I.

RECENT DEBT LEGISLATION IN BOMBAY.

The Bombay Agricultural Debtors' Relief Act (1947) provides for scaling down compulsory debts not exceeding Rs 15,000 of cultivating agriculturists.

The aid of the Act may be invoked in two ways. Either the debtor or the creditor may apply to the Court for the adjustment of debts, or the debtor and his creditor or creditors may come to a settlement and apply to the Court for recording and certifying such a settlement

Firstly, the act enables the debtor or the creditor to submit to the Court a written application in a prescribed manner before a certain date for the adjustment of his debts When such an application has been made, other creditors like the Government, local bodies, co-operative societies and Scheduled Banks are also required to state the amount of the debt due to them and the amount they are willing to remit The debtor and his creditor or creditors have also to submit statements of accounts to the Court, in a prescribed manner It is provided by the Act where in respect of a certain debt no application is made, the debt shall be deemed to have been extinguished

Secondly, the debtor and his creditor or creditors may arrive at a settlement in respect of any debt due by the debtor to the creditor or creditors, and in such a case, the debtor or any of his creditors may make an application to the Court to record and certify such a settlement When such an application is made the Court is empowered to certify the same if it thinks that the settlement is just and fair

Except in a case where the transaction took place 30 years before 30th January, 1940, and settlement had been arrived at between the debtor and his creditor or creditors to which the debtor or the person through whom the liability is derived, had given his written consent by putting his signature to such a settlement, in the case of all other debt transactions for the adjustment of which an application has been made either by the debtor or his creditor or creditors, the Court is authorised to enquire into the history and merits of the case and take accounts between the parties and determine the amount due to each of the creditors at the date of the application applying the following rules

In arriving at the amount of debt and interest due to the creditors, the Court will make separate accounts of principal and interest The amount actually received by the debtor will be deemed as the principal amount and interest is that amount awarded under any decree or order of a competent court. Where it is not clear and it would not be possible to separate principal from the interest amount, then two-thirds and one-third of the debt amount awarded by such decree or order will be deemed to be the amount of principal and interest respectively.

(2) In the case of transactions which commenced before 1st January, 1931 the Court will take accounts upto the date of the institution of the suit calculating simple interest at the rate agreed to between the parties or 12 per cent per annum whichever is the lowest on the balance of the amount actually due on the date of the institution of the application. Then the principal and interest amount so arrived at will be reduced by 40 per cent and the reduced amount will be considered as due.

(3) In the case of transactions commencing after 1st January, 1931 and before 1940 the Court will take accounts calculating the interest at the agreed rate between the parties or at 9 per cent whichever is the lowest on the balance of the amount due on that date and the principal and interest amounts thus arrived at will both be reduced by 30 per cent and the reduced amount will be deemed to be the amount due on the date of the institution of the adjustment proceedings

(4) In the case of transactions which commenced on or after the 1st January, 1940, in the account of interest there will be debited to the debtor simple interest on the balance of the principal for the time being outstanding at the rate agreed upon between the parties, or at the rate allowed under any decree passed between the parties, or at a rate not exceeding 6 per cent per annum whichever is the lowest

After taking the accounts as said above the Courts will proceed to determine the particulars of the property belonging to the debtor, the value of the said property, particulars of any incumbrances on that property and the paying capacity of the debtor

In the evaluation of the property of the debtor, the property or assets which are exempt from attachment under Civil Procedure Code will not be taken into account Further, the amounts due as land revenue or tax payable to

Government or any other sum due to it by way of loan or otherwise, or any tax payable to a local authority or any other sum payable to such authority by way of loan or otherwise, or any sum due to a co-operative society, or any sum advanced solely for the purpose of financing of crops, or any sum due under a decree or order for maintenance passed by a competent court, or any sum due to a Scheduled Bank will be deducted.

After ascertaining the debtor's paying capacity which has been fixed by the Act as 60 per cent of the value of all the property of the debtor, the debts will be scaled down further as follows

(1) If all the debts found due by a debtor after taking accounts are unsecured, they will be further scaled down pro-rata to the paying capacity of the debtor

(2) If all the debts found due by a debtor after taking accounts are secured debts, and the total amount of such debts is more than 60 per cent of the value of the property belonging to the debtor, such debts will be further scaled down pro-rata to the paying capacity of the debtor

(3) If the debts found due by a debtor after taking accounts are both secured and unsecured and if the total amount of the secured debts is more than 60 per cent of the value of the property on which such debts are secured, the secured debts will be further scaled down pro-rata to 60 per cent of the value of the property on which such debts are secured and the unsecured debts will be further scaled down pro-rata to 60 per cent of the value of the other property belonging to the debtor over which no debts are secured

After determining the amount of debts scaled down as said above the Court will make an award and arrange for payment according to the priority fixed by the Act The payments will have to be made in not exceeding 12 instalments Where during the course of the adjustment proceedings the court finds that the property of the debtor is insufficient to enable the debtor to pay off the debts in 12 instalments, it will declare the debtor an insolvent

In fixing the instalment, the Court will take into consideration the net annual income of the debtor The net annual income is to be arrived at after deducting (1) such sums as may be necessary for payment of the liability, if any, imposed on the debtor under a decree or order for

maintenance passed by a competent court, (2) such sum as may be considered necessary for the maintenance of the debtor and his dependants, (3) the sum required by the debtor to pay the assessment and taxes in respect of the current year to Government and local authorities and to pay off the loans borrowed for the financing of crops

After scaling down the debts if it is found that the debts of the debtor exceed half the value of the debtor's immovable property, the Court will ascertain from the creditors whether they would be willing for further scaling down to an amount equal to half the value of the debtor's immovable property. If they agree, the Court will call upon the debtor to pay off the debt within one month or within such time as it may grant to the debtor. If the debtor does not pay the Court will make an award directing the primary Land Mortgage Bank situated in the local area or if there is no such primary land mortgage bank in that area, the Bombay Provincial Land Mortgage Bank to pay the creditors in cash the debt as finally scaled down or if the creditors so desire in bonds issued by the Bombay Provincial Land Mortgage Bank, such bonds being guaranteed by the Provincial Government, for such amount in full satisfaction of all the debts due to them from the debtor The Court will further direct that such amount will be charged on all the immovable property of the debtor.

With the enactment of the above Act, the Debt Adjustment Boards created under the Bombay Agriculturists Debtors' Relief Act of 1939 have been dissolved and pending cases have been transferred to the courts for disposal as per the Act of 1947.

APPENDIX II.

Relevant Sections of the Indian Companies Act as amended in 1936 relating to Banking Companies

Sec 277F. A 'Banking Company' means a Company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in any one or more of the following forms of business, namely --

(1) borrowing, raising or taking up of money, the lending or advancing of money either upon or without security, the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts, and other instruments, and securities whether transferrable or negotiable or not, the granting and issuing of letters of credit, travellers' cheques, and circular notes, the buying, selling and dealing in bullion and specie, the buying and selling of foreign exchange including foreign bank notes, the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debenture stock, bonds, obligations, securities and investments of all kinds, the purchasing and selling of bonds, scripts and other forms of securities on behalf of constituents or negotiating of loans and advances, receiving all kinds of bonds, scripts or valuables on deposits or for safe custody or otherwise, the collecting and transmitting of money and securities,

(2) acting as agents for Governments or local authorities or for any other person or persons, the carrying on agency business of any description other than the business of

a managing agent (of a company not being a Banking Company) including the power to act as attorneys and to give discharges and receipts,

(3) contracting for public and private loans and negotiating and issuing the same,

(4) promoting, effecting, insuring, guaranteeing, underwriting, participating in Managing and carrying out of any issue—public or private, of State, Municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue,

(5) carrying on and transacting every kind of guarantee and indemnity business,

(6) promoting or financing or assisting in promoting or financing any business undertaking or industry, either existing or new, and developing or forming the same either through the instrumentality or syndicate or otherwise,

(7) acquisition by purchase, lease, exchange, hire or otherwise of any property immovable or movable and any rights or privileges which the Company may think necessary or convenient to acquire or the acquisition of which in the opinion of the company is likely to facilitate the realisation of any securities held by the Company or to prevent or diminish any apprehended loss or liability,

(8) managing, selling, and realising all property movable and immovable which may come into the possession of the Company in satisfaction or part satisfaction of any of its claims,

(9) acquiring and holding and generally dealing with any property and any right title or interest in any property movable or immovable which may form part of the security for any loans or advance or which may be connected with any such security,

(10) undertaking and executing trusts,

(11) undertaking the administration of estates as executor, trustee or otherwise,

(12) taking or otherwise acquiring and holding shares in any other company having objects similar to those of the Company,

(13) establishing and supporting or aiding in the establishment and support of associations or institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company,

(14) the acquisition, construction, maintenance and alteration of any building of the Company,

(15) selling, improving, managing, etc, . . with any of the property of the Company;

(16) acquiring and undertaing whole or any business when such business is of a nature enumerated or described in this section,

(17) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the Company

Limitations of activities of Banking Company

Sec 277G. (1) No Company formed after the commencement of the Indian Companies (Amendment) Act 1936 for the purpose of carrying on business as a banking Company or which uses as part of the name under which it proposes to carry on business the word 'bank', 'banker', or 'banking' shall be registered under this Act unless the memorandum limits the objects of the Company to carrying on of the business of accepting deposits of money on current account or otherwise subject to the withdrawal by cheque draft or along with some or all of the forms of business specified in Sec 277F.

(2) No Banking Company shall after the expiry of two years from the commencement of this Act shall carry on any form of business other than those specified in Sec 277F.

Provided that the Central Government may, by notification in the official Gazette, specify in addition to the business set forth in clauses (1) to (17) of Section 277F other forms of business which it may be lawful under this section for a banking company to engage in

Banking Company not to employ managing agent

Sec. 277H. No banking company shall after the expiry of two years from the commencement of the Indian Companies (Amendment) Act, 1936, employ or be managed by a managing agent other than a banking company for the management of the Company

Sec. 277HH. No banking company, whether incorporated in or outside British India, which carries on business in British India shall, after the expiry of two years from the commencement of the Indian Companies (Amendment) Act, 1944, employ or be managed by a managing agent, or any person whose remuneration or part of whose remuneration, takes the form of commission or a share in the profits of the company, or any person having a contract with the company for its management for a period exceeding five years at any one time

Provided that the period of five years shall, for the purpose of this section, be computed from the date on which this section comes into force,

Provided further that any such contract may be renewed or extended for a further period not exceeding five years at a time, if and so often as the directors think fit

Restriction on commencement of business and conditions for carrying on business by banking company.

Sec. 277I. Notwithstanding any thing contained in Sec 103 no banking company incorporated under this Act on or after the 15th day of January 1937 shall commence business unless shares have been allotted to an amount sufficient to yield a sum of at least fifty thousand rupees as working capital, and unless a declaration duly verified by an affidavit signed by the directors and

the manager that such a sum has been received by way of paid up capital has been filed with the registrar

Prohibition of charge on unpaid capital.

Sec. 277J. No banking company shall create any charge upon any unpaid capital of the company, and any such charge shall be invalid.

Reserve Fund: Cash Reserves

Sec. 277K (1) Every banking company shall, after the commencement of the Indian Companies (Amendment) Act, 1936, maintain a reserve fund

(2) Every banking company shall out of the declared profits of each year and before any dividend is declared transfer a sum equivalent to not less than twenty per cent of such profits to the reserve fund until the amount of the said fund is equal to the paid up capital

(3) A baking company shall invest the amount standing to the credit of its reserve fund in Government securities or in securities mentioned or referred to in section 20 of the Indian Trusts Act, 1882, or keep deposited in a special account to be opened by company for the purpose in a scheduled bank as defined in clause (e) of section (2) of the Reserve Bank of India Act, 1934·

Provided that the provision of the sub-section shall not apply to a banking company incorporated before the commencement of the Indian Companies (Amendment) Act, 1936, till after the expiry of two years from the commencement of the said Act

Sec 277L (1) Every banking company shall maintain by way of cash reserve in cash a sum equivalent to at least one and a half per cent of the time liabilities and five per cent of the demand liabilities of such company and shall file with the registrar before the tenth day of every month (three copies of)

a statement of the amount so held on the Friday of each week of the preceding month with particulars of the time and demand liabilities of each such day.

(2) For the purposes of sub-section (1) "demand liabilities" means liabilities which must be met on demand, and "time liabilities" means liabilities which are not demand liabilities.

(3) Nothing in this section or in section 277K shall apply to a scheduled bank as defined in clause (e) of Section 2 of the Reserve Bank of India Act, 1934

(4) If default is made in complying with the requirements of section 277G, section 277H, "section 277HH, section 277I", section 277J, section 277K or section 277M or with the requirements of this section as to the maintainance of a cash reserve, every director or other officer of the company who is knowingly and wilfully a party to the default shall be liable to a fine not exceeding five hundred rupees for every day during which the default continues, and if default is made in complying with the requirements of this section as to the filing of the statement referred to in sub-section (1), to a fine not exceeding one hundred rupees for every day during which the default continues

Restriction on nature of subsidiary companies

Sec. 277M. (1) A banking company shall not form any subsidiary company except a subsidiary company formed for the purpose of undertaking and executing trusts, undertaking the administration of estates as executor trustee or otherwise and such other purposes set forth in section 277F as are incidental to the business of accepting deposits of money on current account or otherwise

(2) Save as provided in sub-section (1), a banking company shall not hold shares in

any company whether as pledgee, mortgagee or absolute owner of an amount exceeding forty per cent of the issued share capital of that company

Provided that nothing in this sub-section shall apply to shares held by a banking company before the commencement of the Indian Companies (Amendment) Act, 1936

Sec. 277N. (1) The Court may on the application of a banking company which is temporarily unable to meet its obligations make an order staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper and may from time to time extend the period

(2) No such application shall be maintainable unless accompanied by a report of the registrar

Provided, however, the Court may, for sufficient reasons, grant interim relief, even if the application is not accompanied by such report

(3) The registrar shall for purposes of his report be entitled at the cost of the company to investigate the financial condition of the company and for such purpose to have the books and documents of the company examined by an accountant holding a certificate issued under section 144

APPENDIX III.

Remittance facilities offered to Scheduled Banks by the Reserve Bank of India

Under the Scheme of remittance facilities in India and Burma introduced by the Reserve Bank of India from the 1st October 1940, a Scheduled Bank is entitled to remit money by mail or telegraphic transfers between the accounts kept by its offices, branches, sub-offices and pay offices at any office, branch or agency of the Reserve Bank in India as follows —

(i) (a) An amount of Rs 10,000 or a multiple thereof, between its accounts at the offices and branches of the Reserve Bank free of charge,

(b) once a week an amount of Rs 5,000 or a multiple thereof to the principal amount which it maintains with the Reserve Bank from any place at which it has an office, branch, sub-office or pay office and at which there is an agency of the Reserve Bank, free of charge,

(c) other remittances and principal amount subject to a charge of 1 64 per cent and also subject to a minimum charge of Re 1, and

(d) other remittances between accounts maintained at the Reserve Bank or its agencies

Upto Rs 5,000	..	1/16 per cent. (minimum Re 1)
Rs 5,000 or over	.	1/32 per cent (minimum Rs 3/2)

(ii) In addition telegraphic transfers and drafts in favour of third parties are issued, subject to the limits on drawings on Treasury agencies, at the following rates —

Upto Rs 5,000	.	1/16 per cent (minimum Re 1)
Over Rs 5,000	.	1/32 per cent. (minimum Rs 3/2)

Actual telegram charges are charged in addition

APPENDIX IV.

FORM OF BALANCE SHEET

Bank, Ltd

Balance Sheet as at *December*

CAPITAL & LIABILITIES

Authorised Capital Shares of Rs each
Issued Capital Shares of Rs each
Subscribed Capital Shares of Rs each
Amount called up at Rs per share

Less calls unpaid
Add forfeited shares

Reserve Funds (*b*)
Deposits and other accounts
Fixed deposits
Savings Bank Deposits
Current Account and contingency (unadjusted) accounts
Due to other Banks, Agents etc
(i) in British India
(ii) outside British India

Particulars —
(i) Secured (Stating the nature of security)
(ii) Unsecured
Bills payable

PROPERTY & ASSETS

Cash in hand and with Reserve Bank (including foreign currency notes)
Balances with other Banks (showing whether on deposit or on current account)
(i) in British India
(ii) outside British India
Money at Call and short notice
Bills discounted (other than Treasury bills of the Central and Provincial Governments)
(i) payable in British India
(ii) payable outside British India
Investments (stating mode of valuation e g cost or market value)
(i) Government of India and Trustee Securities including Treasury Bills of Government of India and Provincial Governments
(ii) Shares (showing separately shares fully paid up and partly paid up)
(iii) Debentures or Bonds
(iv) Other investments (to be specified)
(v) Gold

Bills for collection being bills receivable as per contra

(i) Payable in British India

(ii) Payable outside British India

Other Liabilities (*c*)
(to be specified)

Acceptances, endorsements and other obligations as per contra

Profit and Loss

Balance as per previous Balance Sheet

Less appropriation thereof balance brought forward

Profit since last Balance Sheet

Contingent Liabilities (*d*)

Loans, Advances, Cash Credits and Overdrafts
(*Less* provision for bad and doubtful debts)

(i) in British India

(ii) outside British India

Particulars

(i) Debts considered good in respect of which the Bank is fully secured

(ii) Debts considered good for which the Bank holds no other security than the debtors' personal security

(iii) Debts considered doubtful or bad not provided for

(iv) Debts due by Directors or officers of the Bank or any of them either severally or jointly with any other person

(v) Debts due by Companies or firms in which the Directors of the Bank are interested as Directors or partners or Managing Agents

(vi) Maximum loans including temporary advances made at any time during the year to Directors or Managers of the Company

(vii) Maximum amount of loans including temporary advances granted during the year to the Companies or firms in which the Directors of the Bank are interested as Directors, or partners or managing agents

(viii) Due from Banks Bills for collection being bills receivable as per contra

	(i) Payable in British India
	(ii) Outside British India, Acceptances, endorsements *and* other obligations per contract
	Premises (c) *Less* depreciation
	Furniture & Fixture, *Less* depreciation
Total	Total

FROM OF PROFIT AND LOSS ACCOUNT

Profit and Loss Account for the year ended . December.

EXPENDITURE	INCOME
Interest paid on deposits	Interest, Discount, Exchange, Commission, etc (*Less* provision made during the year for bad and doubtful debts)
Salaries and Allowances	Transfer from contingencies account
Directors' Fees and Allowances	Profit made on sale or revaluation of investments, Gold and Silver
Provident Fund	Miscellaneous
Rent, Taxes, Insurance, Lighting, Law Charges	Loss (*if any*)
Postage and Telegrams	
Auditors' Fees	
Depreciation on Bank's Property	
Repairs to Bank's Property	
Stationery, Printing, Advertisements, etc	
Other Expenditure	
Balance of Profit	
Total	Total

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